UNIFORM COMMERCIAL CODE

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ARTICLE 1 - GENERAL PROVISIONS

PART 1.

1-101. Short Titles.

(a) This [Act] may be cited as the Uniform Commercial Code.

(b) This article may be cited as Uniform Commercial Code-General Provisions.

1-102. Scope of Article.

This article applies to a transaction to the extent that it is governed by another article of [the Uniform Commercial Code].

UNIFORM COMPUTER INFORMATION TRANSACTIONS ACT Revised October 15, 1999

Official Comments:

1. "**Access contract**." An access contract is an agreement that authorizes access to an electronic facility, including a computer or Internet site, authorizes obtaining information from that type of facility, or allows an equivalent form of access. The term does not include contracts granting a right to enter a building or other physical location, or the purchase of a television, radio, or similar goods merely to create technological ability to access information. An "access contract" is typified by "on-line" services, but also includes contracts for remote data processing, third party e-mail systems, and contracts allowing automatic updating from a remote facility to a database held by the licensee.

The term does not cover interactions among computer programs within a person's own system – the access must be to another person's system. Thus, when a licensee of a spreadsheet uses it to interact with and obtain information from computers on the licensee's network, that is not an access contract because the licensee is supplying all programs and systems. However, another person can provide the equivalent of access, and thereby create an access contract, even though the information is only used in the licensee's system. For example, an on-line data provider may elect to provide access to data in part by allowing its database to be loaded into the computer of a client, this performance retains all characteristics of an access contract and is within the definition. The same is true if the contract allows a copy of the database to be loaded into the user's system, but the data are intermittently updated with data from remote systems. On the other hand, if a software publisher simply allows downloading of software into a licensee's system, the continuing right to use the software after it is downloaded is not an access contract.

An access provider may, or may not, be able to give contractual rights in the information accessed. Some transactions entail a three-party framework: in addition to the customer, one licensor provides access, while another (the content provider) licenses the information. This transaction involves two and, in some cases, three contracts. The first is between the content provider and the access provider. The second is between the access provider and the end user. The third arises if the content provider contracts directly with the end user, that too is an access contract. The contracts are independent of each other.

2. "**Agreement**". This term is from Uniform Commercial Code § 1-201 (1998 Official Text). As in Article 1, whether an agreement has legal consequences is determined by this Act or other applicable law. The term includes full recognition of usage of trade, course of dealing, course of performance and the surrounding circumstances as effective parts of an agreement. The meaning of the agreement of the parties is determined by the language they use and their actions, interpreted in the light of commercial practice and other surrounding circumstances. See Section 113(b); Section 301 (parol evidence rule). Whether an agreement has legal effect 5 is determined by this Act. Section 114(d).

3. "**Attribution procedure**." An "attribution procedure" is a procedure to identify the person who sent an electronic message, or to verify the absence of changes in its content, agreed to or adopted by the parties or otherwise established by applicable law. The agreement may occur between the two parties or through a third party. For example, the operator of a multi-database system which includes information provided by third parties, may arrange with database providers and customers for use of a particular attribution procedure. Those arrangements, although made with the third party, establish an attribution procedure for purposes of this Act between the customers and the individual database providers. The substantive provisions related to attribution are set out in Sections 108 and 213.

4. "**Authenticate**." This term replaces "signature" and "signed." A similar change is in Uniform Commercial Code Article 9 (1998 Official Text). The definition makes clear that qualifying electronic systems are adequate for what once were paper-based requirements. The definition is technologically neutral.

Any signature under prior law is an authentication under this Act. Like a signature, an "authentication" may express various effects. The ordinary effects are (i) accepting an agreement, and (ii) adopting of a record or specific term(s). Authentication may serve other functions such as confirming the content of the record or identifying the person. What effects are intended are determined by the context and objective indicia associated with that context. There is no requirement that the authentication be in a record retained by a party.

Authentication may be on, logically associated with, or linked to the record. In digital technology, the analogy between signing a record electronically and signing a paper is not precise. "Logically associated" makes it clear that the association between an authentication and a record need not be physical in nature. It can be electronic. However, there must be an association supporting the inference that the authenticating party intends to adopt or accept the associated or referenced record. "Referring to" or "linked to" captures a similar concept applicable to the Internet and similar systems, indicating that it is adequate to have an electronic connection, such as an Internet hyperlink.

Authentication includes qualifying use of any identifier such as a personal identification number (PIN) or a typed or otherwise signed name. It includes qualifying actions and sounds such as encryption, voice and biological identification, and other technologically enabled acts. A voice print, voice recognition, or similar technology is adequate if, as with the other options, done with the proper intent In all cases, of course, establishing the efficacy and the commercial reasonableness of attribution is covered by Sections 108 and 213.

5. "**Automated transaction**." This term refers to contracts formed automatically and which are effective even though one or both parties is represented by an electronic agent instead of a human being (an individual). Operations of automated systems can create binding legal obligations for those who use them for that purpose. It may be that in some systems a human might actually review a particular transaction or aspect of it before the transaction is completed, such as when there is a problem with the system. If such review is made other than in the ordinary course, the transaction still can qualify as an automated transaction.

8. "**Cancellation**." This definition follows the Uniform Commercial Code § 2-106(4) (1998 Official Text); no substantive change is intended by language variations. Cancellation is a remedy for breach. The effect of cancellation is stated in Section 802.

9. "**Computer**". The definition of "computer" draws on definitions in federal and state criminal, tax and other statutes regarding computers. The definition should be applied by the courts with common sense. The term does not include a traditional television set, radio or toaster even though it includes a computer chip. It might include new generations of machines that combine computation, word processing, Internet access, and traditional broadcast reception. Under various state statutes, unauthorized access to a computer is a crime, but while the definition of computer in those statutes is typically broad, courts exercise discretion and common sense in applying the definition which should also apply here. Thus, while an automobile might contain a computer or several computers, the automobile is not itself a computer.

10. "**Computer information**." This term focuses on information that is in an electronic form that is obtained from, accessible with, or useable by, a computer; it includes the information as well as a copy of it (e.g., diskette containing the information) and its documentation (including non-electronic documentation). The reference to "electronic" by that definition includes digital or information in a form having similar capabilities covering analog and future computational technologies.

Eliminating the possibility that a limit to "digital" technology would limit the Act to current technology. The term does not include information merely because it could be scanned or entered into a computer; it is limited to electronic information in a form capable of being directly processed in a computer. The term does not generally include printed information or other non-digital formats in which information is encompassed, but which are not directly useable in computers.

11. "**Computer information transaction**." This term establishes the scope of this Act. (Section 103) It requires an agreement involving computer information. The mere fact that parties agree to communicate in digital form does not bring a transaction within this definition, nor does a decision by one party to use computer information when the contract does not require it to do so. An agreement to use e-mail to communicate about a contract for shipment of petroleum does not bring that transaction within this definition.

A contract for an airline ticket is not a computer information transaction simply because the ticket may be in digital form. The subject matter is not the computer information, but the service – air transportation from one location to another. The term does not cover the many cases in which a person provides computer information to another for purposes of another transaction, such as making an employment or loan application.

The term includes transfers of computer programs and software development contracts. A transaction is not for the "creation" of computer information in the sense intended here where the contracted-for activities are merely secretarial or clerical in nature. The computer information must be created, i.e, produced through some business, professional, artistic, or imaginative effort.

11. "**Computer program**." The first sentence parallels copyright law. 17 U.S.C. 101 (1998). The second sentence distinguishes between computer programs as operating instructions and "informational content" communicated to human beings. As used in this Act, "computer program" refers to functional and operating aspects of a digital or similar system, while "informational content" refers to output that communicates to a human.

For any issue requiring this distinction, the answer lies in whether the issue concerns operations (program) or communicated content (informational content). This definition pertains solely to contract law issues. It does not relate to the copyright law issue of distinguishing between a process and copyrightable expression. The distinction here is more like that in copyright law between a computer program as a "literary work" (code) and output as an "audiovisual work" (images, sounds). In copyright, that distinction relates to property and infringement issues. In this Act, the distinction relates to contract law issues such as liability risk and performance obligation.

13. "Consequential damages." This is from Uniform Commercial Code 2-715(2)(1998 Official Text). The definition does not specifically exclude losses that could be avoided by mitigation through cover or otherwise, but a duty to mitigate is an express limit on all damage claims under Section 807; no change in law is intended. A party can recover compensation only for losses that it could not reasonably have avoided. Of course, the idea of avoidance through reasonable steps such as cover or otherwise must be assessed with due regard to how damages are measured. For example, where recovery is based on the idea of lost volume, the damages measure itself assumes that another transaction is not a substitute for the first (lost) transaction and the idea of mitigation through a replacement transaction is not germane. See discussion of substitute transactions in Sections 808 and 809.

Consequential damages do not include "direct" or "incidental" damages. Consequential loss includes loss of anticipated benefits as a result of not being able to exploit or rely on the expected contracted performance, such as lost profits, damage to reputation, lost royalties that would have been accrued from a licensee’s proper performance, lost value of a trade secret from wrongful disclosure or use, lost income from wrongful gains for the other party from misuse of confidential information, loss of privacy, and loss or damage to data or property caused by a breach.

Except as provided in Section 807 or as limited by agreement, consequential damages may be recovered by either party. The losses must be an ordinary and predictable result of the breach. They must have been foreseeable. For the injured party to recover for economic losses resulting from its special circumstances, the party in breach must have had notice of those circumstances at the time of contracting. In contrast, losses from ordinary general requirements can often be presumed to have been within the contemplation of the other party. In addition, to be foreseeable the losses must not result from atypical risk taking by the aggrieved party, such as in a failure reasonably to maintain back-up systems for retrieval of data.

Damage to other property (e.g., property not within the contract itself) may be consequential damage. The definition follows Article 2 of the Uniform Commercial Code regarding personal injury or property damage by requiring proof that the damage "proximately" resulted from the breach. If injury follows use of a computer program without discovery of a defect causing the damage, the question of "proximate" cause includes considering whether it was reasonable for the injured party to use the information without inspection that would have revealed the defect. Also, proximate causation may not exist where damages result from misuse or a use that violates clear warnings against the particular type of use.

The term does not include direct damages.

14. "**Conspicuous**." This definition is from Uniform Commercial Code 1-201(10) (1998 Official Text), but adjusts the standard to reflect modern practice, including electronic commerce. Whether a term is conspicuous is determined by the court. Section 114. This Act also uses the concept of manifesting assent to a contract term in some cases as a means of ensuring that a term is called to the attention of a reasonable person. "Conspicuous" does not relate to or change any requirement of any other law that specifies the content, timing or manner of disclosure of information or warnings.

A term is conspicuous if it is so positioned or presented that the attention of an ordinary individual reasonably ought to have been called to it. Often, conspicuous terms are presented in a record, but the concept is not so limited; it includes verbal or automated voice presentation that meets the basic standard. Whether a term is conspicuous is gauged by the condition of the message as it would be received or first viewed by a person using an ordinary system or method of receiving or reviewing

such messages unless, of course, the provider of the term knows that the recipient is using a different system. If a transaction involves use of an electronic agent, presentation of the term must be capable of invoking a response from a reasonably configured electronic agent.

As in Uniform Commercial Code Section 1-201(10) (1998 Official Text), this Act delineates some methods of making a term conspicuous. The policy behind requiring that a term be conspicuous blends a notice function (the term ought to be noticed) and a planning function (giving certainty to the party relying on the term on how that result can be achieved). The illustrations establish safe harbors intended to reduce uncertainty and litigation. The illustrations are not exclusive. Outside the illustrative safe harbors, the general standard governs.

The definition updates prior law under the Uniform Commercial Code and recognizes methodologies relevant in electronic commerce. Paragraph (A)(ii) contemplates setting off the term or a label by symbols so that conspicuous formatting can be reliably transferred in electronic commerce (font size, color and other attributes might not always be transferable). It includes a term or reference that provides: *** Disclaimer *** or <<< Disclaimer >>>. Paragraph (A)(iii) deals with hyperlinks and related Internet technologies. It contemplates a case in which a computer screen displays an image or term or a summary or a reference to it, and the party using the screen, by taking an action with reference to it, is promptly transferred to a different display or location wherein the contract term is available. To be conspicuous, the image, term, summary or reference must be prominent and its use must readily enable review of the term.

The access must be **from** the display and not by taking other actions such as a telephone call or driving to a store. When the term is accessed, it must be readily reviewable. The fact that an entire contract record is prominently referenced does not automatically mean that a particular **term** in that record is conspicuous. Good faith in the performance of these provisions is required. Section 114. If other law requires specific content, location, or timing of disclosure, those requirements apply under Section 105 and Section 114.

Paragraph (B) operates independently of paragraph (A) and recognizes a procedure by which, without taking action with respect to the term or reference, the party cannot proceed. Thus, a screen that states: "There are no warranties of accuracy with respect to the information" in a manner that might not meet paragraph (A),but is displayed in a way that precludes the user from proceeding without assenting to or rejecting this condition, suffices.

15. "**Consumer**" and "consumer contract." A "consumer" is a human being (individual) who obtains information primarily for personal, household, or family purposes. Whether an individual is a consumer with reference to a particular transaction is determined at the time of contracting. It depends on the then intended use of the information. Many "personal" contracts are not consumer contracts (e.g., stock broker employee of a brokerage house personally acquiring software to monitor client investments). The definition distinguishes profit making, professional or business use, from non-business, personal or family use. Only when the contract is primarily for the latter is there a consumer contract.

The profit-making standard for determining whether a transaction is a consumer contract is followed in many other areas of law. See, e.g., *Thomas v. Sundance Properties*, 726 F.2d 1417 (9th Cir. 1984); *In re Booth*, 858 F.2d 1051 (5th Cir. 1988); *In re Circle Five, Inc.,* 75 B.R. 686 (Bankr. D. Idaho 1987); Truth in Lending Act, 15 U.S.C. 1603 (excluding from the act's protection of consumer credit, extensions of credit "primarily for business, commercial, or agricultural purposes"). A purpose stated in the agreement would ordinarily determine the purpose of the transaction for this definition.

16. "**Contract**." This is from Uniform Commercial Code § 1-201(11) (1998 Official Text).

17. "**Contract fee**." This term includes any monetary payment required under a contract.

18. "**Contractual use term**." This term includes any enforceable restriction that defines or limits access to, use or disclosure of information or informational rights created by a contract under this Act. Use terms relate only to the copies and information provided under the contract. Unless otherwise expressly indicated, a contractual use term does not govern use of the same information lawfully obtained from other sources. The be within this definition the use restriction or permission must come from a contract. The term does not include limitations imposed by property or regulatory law. The term must be enforceable under this Act and other law to be within the definition. Thus, if trade secret law precludes enforcement of a particular non-competition term, that term is not a contractual use term to the extent of its unenforceability.

19. "**Copy**." This term refers to the media containing information. In this Act, the term is used with reference to questions associated with contractual events such as delivery, tender, and enabling use. For these purposes, in appropriate cases, the time during which the information is fixed on a media can be temporary if this fulfills the purpose of the performance. This Act does not deal with the copyright law question of whether a brief reproduction in computer memory is an infringement.

Stenograph v. Bossard, 46 U.S.P.Q.2d 1936 (D.C. Cir. 1998); *MAI Systems Corp. v. Peak Computer, Inc.*, 991 F.2d 511 (9th Cir. 1993).

20. "**Course of dealing**." This is from Uniform Commercial Code 1-205 (1998 Official Text). The term is restricted to a sequence of conduct between the parties prior to the agreement at issue.

21. "**Course of performance**." This is from Uniform Commercial Code 2-208 (1998 Official Text). Conduct prior to the agreement is covered under the related term "course of dealing." Both are part of the commercial approach to understanding contracts based on practical interpretation adopted in this Act. The parties themselves know best what they meant by their agreement and their conduct is often the best indication of what that meaning was. A course of performance is always relevant to determine the meaning of the agreement. See Uniform Commercial Code 1-205, *comment* 2 (1998 Official Text).

22. "**Delivery**." Delivery can occur either through transfer of possession of a tangible copy or by electronic transfer. In electronic transfers, a copy may not *move* from one location to another. Transfers often entail copying the information into another location or making it available for use in a common system shared or accessible by the recipient and the person making the delivery.

23. "**Direct damages**." Direct damages are compensation for losses associated with the value of the contracted for performance itself as contrasted to loss of a benefit expected from intended use of the performance or its results. Direct damages are measured by formulae in Sections 808(b) and 809(a). They are capped by the contracted-for price and market value for the performance as appropriate. This Act rejects cases that treat as direct damages losses that relate to anticipated benefits from use of information such as *Chatlos Systems, Inc. v. National Cash Register Corp.,* 670 F.2d 1304 (3d Cir. 1982). Those are consequential damages. Thus, if a computer program is purchased for $1,000 and, if merchantable, would yield profits or cost savings in business of $10,000, but it is totally defective, "direct" damages are $1,000. If recoverable, the lost profits or expected cost savings are consequential damages. .

24. "**Electronic**." This term is open-ended, technology neutral, and encompasses forms of information processing technology that may be developed in the future.

25. "**Electronic agent**." This term refers to an automated means for making or performing contracts. The agent must act independently in a manner relevant to creation or performance of a contract. Mere use of a telephone or e-mail system is not use of an electronic agent. The automated system must have been selected, programmed or otherwise used for that purpose by the person that is bound by its operations. The legal relationship between the person and the automated agent is not fully equivalent to common law agency, but takes into account that the "agent" is not a human. Parties who adopt use of electronic agents are ordinarily bound by the results of their operations.

26. "**Electronic Message**." A message is distinguished from a "record" by the fact that it is intended to be communicated to another person or an electronic agent; it does not merely record information. Communication of a message may entail copying it into another location or making it available for use in a common system shared by or accessible to the recipient. In effect, it is stored or generated for purposes of communicating to another.

27. "**Financial accommodation contract**." A financial accommodation occurs in a loan in whole or in part for information or in a lease of a copy of computer information. The recipient of the accommodation is the licensee. A security interest is not within this definition; security interests are governed by Uniform Commercial Code Article 9. An agreement under which royalties for use of information accrue over time and are paid periodically is not a financial accommodation, but simply a royalty-bearing license (or assignment) of rights in the information. The financial accommodation contract can be in any form, including in a lease of goods or a lease of software.

28. "**Financial services transaction**." This term includes a variety of financial system activities and transactions governed under federal and other state law and are not covered in this Act. Section 103(d).

29. "**Financier**." A financier is a lender or a lessor dealing with the licensee under a financial accommodation contract. The financier may have any of several relationships to licensed computer information. One relationship is that the financier obtains rights as a licensee for purposes of transfer to the eventual licensee who is also the accommodated party. This is like a finance lease under Uniform Commercial Code Article 2A, but deals with licensed computer information, rather than leased goods. A second relationship is where the party giving the accommodation does not obtain rights in the license as against the licensor, but obtains a contractual right to prevent the licensee's use of the information in the event of breach of the financial accommodation contract.

The licensor of the underlying license is not a financier for purposes of this Act. The licensor may obtain a security interest under Article 9 and would, with respect to that interest, have the rights of a secured party under Article 9.

30. "**Good Faith**." This definition adopts an expanded version of Uniform Commercial Code 1-201 (1998 Official Text), conforming more to Uniform Commercial Code 2-103(b) (1998 Official Text). It rejects the pure "**honesty in fact**" as the sole standard. While good faith in performance of contractual obligations or rights is an element of all contracts covered by this Act, the obligation of good faith does not over-ride express contract terms or the right to enforce them.

See Kham & Nates Shoes No. 2, Inc. v. First Bank of Whiting, 908 F.2d 1351 (7th Cir. 1990); *Amoco Oil Co. v. Ervin,* 908 P.2d 493 (Colo. 1995); *Badgett v. Security State Bank*, 116 Wn.2d 563, 807 P.2d 356 (1991). The primary application of the concept is that, when a party has discretion under the contract, that discretion should be exercised in a good faith manner. *Davis v. Sears, Roebuck & Co.*, 873 F.2d 888 (6th Cir. 1989). Good faith does not require a party act to benefit or avoid harm to the other at the cost of advantages that it fairly has obtained for itself under the agreement.

Good faith is not a negligence or reasonable care standard. "Observance of reasonable commercial standards of fair dealing" is concerned with the fairness of the conduct rather than the care with which an act is performed. Both fair dealing and ordinary reasonable care are judged in light of reasonable commercial standards, but the standards in each case are directed to different aspects of commercial conduct.

31. "**Goods**." This definition corresponds to proposed revisions of Uniform Commercial Code, 1999 proposed draft. It clarifies that computer information, including computer programs, are not goods for purposes of this Act. The definition does not alter definitions of goods or tangible products under any other law.

32. "**Incidental damages**." This term corresponds to use of the same term in Uniform Commercial Code Article 2 (1998 Official Text). Incidental damages are expenses incurred after breach. The term includes the cost of seeking or arranging for mitigation, but not the actual expenditure for the mitigation itself, which are covered in measuring direct or consequential damages.

33. "**Information**." This term embraces a wide range of subject matter, but its use in this Act is limited to transactions within the Act's scope. As used here, "data" refers to facts whether or not organized or interpreted. Data is not limited to subject matter to which informational property rights attach. It includes factual data if the data are the subject of a contractual relationship. A "mask work" is defined in federal law; the term refers to a representational technology used in creation of semiconductor products.

34. "**Information processing system**." This term includes computers and other information processing systems. In this Act, the term is used primarily in reference to sending and receiving notices. In that context, whether the system is a computer is not pertinent.

35. "**Informational content**." This is information whose ordinary use involves communication of the information to a human being (individual). This is the information humans read, see, hear and otherwise experience. For example, if an electronic database of images includes the images and a program enabling display or access to the images, the images are informational content while the search program is not. The Westlaw search program is not informational content, but the text of cases and statutes is. The term applies based on the nature of the information even if the person creating the informational content does not intend to reveal it to others; this is because preparation inevitably involves an intent that the information be perceivable by its creator.

36. "**Informational rights**." This term includes, but is not limited to "intellectual property" rights. It also includes rights created under any law that gives a person a right to control use of information independent of contract, such as may be developing with reference to privacy law. Other laws determine when such rights exist and, as with traditional intellectual property law, the rights need not be exclusive as to all other persons and all uses. This Act does not modify those laws under which such rights are created and exist. The term does not include mere tort claims such as the right to sue for defamation.

37. "**Knowledge**." This is from Uniform Commercial Code § 1-201(25) (1998 Official Text). It does not include constructive notice or any duty to inquire.

38. "**License**." A license is an agreement entailing a limited or conditional contractual transfer of information or a grant of limited or restricted contractual rights or permissions to use information. A contract right entails an affirmative commitment that a party can engage in a specific use, while a contract "permission" means simply that the licensor will not object to the use. Either can be the basis of a license. No specific formality of language is required. For purposes of this Act, the term includes consignments of copies of information, but does not otherwise alter the nature of a consignment. This

definition is solely for purposes of this Act and does not alter treatment under other laws, such as tax law.

A transaction is not a license merely because as a matter of law, a transferor retains informational property rights that restrict the transferee's ability to use the information. The term thus does not include a unrestricted sale of a copy; such a sale lacks express contractual restrictions on use. Similarly, a "copyright notice" which merely states the rights or restrictions in a first sale under copyright law does not change an unrestricted sale of a copy into a license.

To be a license, the contract must control the rights. A license exists if a *contract* grants greater privileges than a first sale, restricts privileges that might otherwise exist, or deals with other issues of scope of use. Whether such terms are enforceable is determined under this Act and applicable federal law. However, this Act does not affect the enforceability of copyright notices that are not part of a contractual relationship.

The existence of a license does not depend on whether the contract transfers title of a copy. Title to a copy (a material object) is distinct from questions about the extent to which use of the information is controlled by contract. The analysis in *DSC v. Pulse Communications, Inc.,* 170 F.3d 1354 (Fed. Cir. 1999) indicates how the issues may be separable. Restrictions in a license that are materially inconsistent with ownership of a delivered copy may result in the holder of the copy not being treated as the owner of the copy.

A license is a contract. To create contractual terms of license, the requirements for an agreement must be met. The term does not include the myriad of non-commercial, casual or other exchanges of information that occur in normal political or social discourse, even if there may be incidental restrictions on use of the information. These casual exchanges do not involve a contractual relationship. Thus, when a friend approaches another and offers to describe the marital problems of a third party if the other does not "tell anyone else," that exchange is not a license under this Act because it is not a contract and because it is not a computer information transaction.

39. "**Licensor**" and "Licensee." These definitions refer to the transferee and transferor in any contract covered by this Act, whether or not the contract is a license. In the frequent situation where each party supplies computer information to the other, each is a licensor as to the information it provides and a licensee as to the information it receives.

40. "**Mass-market license**" and "mass-market transaction." The term "mass market license" is a new term and the definition must be applied in light of its intended and limited function. That function is to describe small dollar value, routine and anonymous transactions involving information that is directed to the general public and the transaction occurs in a retail market available to and used by the general public. A purpose of the definition is to avoid artificial distinctions among business and consumer transferees in an ordinary retail market.

The term includes all consumer contracts and some transactions between businesses in a retail market. It does not include ordinary commercial transactions between businesses using ordinary commercial methods of acquiring or transferring commercial information such as with purchase orders or on terms offered to businesses but not to consumers.

A "**mass-market**" transaction is characterized by 1) the *market* in which the transaction occurs, 2) the *terms* of the transaction, and 3) the *nature* of the information involved. The market is a retail market where information is made available in pre-packaged form under generally similar terms to the general public as a whole and in which the general public, including consumers, is a frequent participant. The prototypical retail market is a department store, grocery store, gas station, shopping center, or the like. These locations are open to, and in fact attract, the general public as a whole.

They are characterized by the fact that, while retail merchants make transactions with other businesses, a predominant type of transaction involves consumers. In a retail market, most transactions involve relatively small quantities, non-negotiated terms, and transactions to an end user rather than a purchaser who plans to resell the acquired product. The products are available to anyone who enters the retail location and pays the stated price.

The computer information must be of a type aimed at the general public as a whole, including consumers. This does not include information products earmarked for a business or professional audience, a subgroup of the general public, members of an organization, or persons with a separate relationship to the information provider. In determining when the definition applies, courts should reflect the purpose of the definition which is to avoid artificial distinctions among business and consumer purchasers in an ordinary retail market.

The transactions covered do not include specialty computer information for business or professional uses, information for specially targeted limited audiences, information distributed in non-retail transactions, or professional use information. The transactions involve computer information routinely

acquired by consumers or that intends to appeal to a general public audience as a whole, including consumers. Generally, this is inconsistent with substantial customization of the information for a particular end user. Customization that is routine in mass markets or that is done by the licensee after acquiring the information does not take the information, and therefore the transaction, outside the concept of a mass-market transaction.

The transaction must be with an end user. An end user licensee is one that generally intends to use the information or the informational rights in its own internal business or personal affairs. An end user is not engaged in the business of reselling, distributing, or sub-licensing the information or rights to third parties, or in commercial public performances or displays of the information, or in otherwise making the information commercially available to third parties.

If the licensee is not a consumer, the terms and quantity in the transaction must be consistent with an ordinary transaction in the retail market. To provide further guidance, subsection (B)(iii) expressly excludes several types of transactions commonly not associated with routine retail transactions. The definition excludes a transaction for redistribution or for public display or performance of a copyrighted work.

These are never a mass-market transaction because they involve no attributes of a retail market. In on-line contracting, consumer contracts are mass-market transactions, but business to business transactions are not. By excluding on-line transactions not involving a consumer, the definition follows an important principle. In the new on-line commerce, it is important not to regulate transactions beyond consumer issues. This gives commerce room to develop while preserving consumer interests.

41. "**Merchant**." This is from Uniform Commercial Code 2-104 (1998 Official Text). The definition covers a person that holds itself out as experienced even if the person did not actually engage in prior transactions of the type involved. The term "**merchant**" has roots in the "law merchant" concept of a professional in business. This status may be based upon specialized knowledge as to the information, specialized knowledge about business practices, or specialized knowledge as to both.

Which kind of specialized knowledge may be sufficient to establish merchant status is indicated by the nature of the provision in which the term is used. In this Act, the term refers primarily to businesses with general knowledge of business practices, rather than to experts in a specific field. Section 401(a) and (e), and Section 403, however, require a more focused expertise in the particular type of information involved.

The reference to attributing knowledge by the employment of an agent confirms that merchant status does not always depend on the principal's knowledge. Similarly, an organization is charged with the expertise of its employees and even persons such as universities, for example, can come within the definition of merchant if they have regular purchasing departments or business personnel familiar with business practices.

42. "**Non-exclusive license**." In this type of license, the licensor does not foreclose itself from making additional licenses involving the same subject matter and scope. A non-exclusive license has been described as nothing more than a promise not to sue. While it often has more commercial aspects, a license does not convey property rights to the licensee.

43. "**Notice**." This is from Uniform Commercial Code § 1-201(25) (1998 Official Text). Notice exists when a person has knowledge or has received notification or has reason to know of a fact. When notice may cease to be effective is not covered by this Act, but is governed by other law.

44. "**Notify**", or "give notice". This is from Uniform Commercial Code § 1-201(26) (1998 Official Text). This term is used when the essential event is the dispatch of the notice, not its receipt. When receipt is the relevant standard, that is stated in the statute.

45. "**Party**." This is from Uniform Commercial Code § 1-201(29) (1998 Official Text). Reference to a "party" includes a person acting through an agent.

46. "**Person**." This term refers to individuals (human beings) and to business or other organizations , whether or not treated in law as formal entities. It is distinguished from the narrower term, "**individual**", which as used in this Act ,refers to a natural human being, whether acting in a representative capacity or solely on it's the individual's own behalf.

47. "**Published informational content**." This type of information is the most closely associated with free expression. In previous technology, this would be newspapers, books, records and the like (which are outside the scope of this Act). For purposes of the scope of this Act, the term applies to computer information. The information must be informational content, that is, intended to communicate to a human being, rather than simply to operate a machine. Informational content is published content within this definition when created for or distributed to a group of recipients as a whole in generally the same form.

The term includes interactive content and content made publicly available in a database, even if only portions are used by individual recipients who, for example, may search the database using a computer programs, since the information is generally available and the end user selects from the available information. That is like the reader of a newspaper who reads part, but not all, of the newspaper. The term also includes the informational product of automated systems that affirmatively supply selected portions of a larger database to individual licensees based on programmed parameters.

The term does not include informational content tailored by individuals (human beings) acting on behalf of the licensor to meet a specific recipient's needs or to information provided in a special relationship of reliance. The phrase "special relationship of reliance" refers to transactions in which the provider knows that a particular licensee plans to rely on particular data that the licensor provides and that the licensee expects that the licensor will tailor the information to the client's business or personal needs.

The relationship arises only with respect to licensors who possess unique or specialized expertise or who are in a special position of confidence and trust with the licensee such that reliance is justified and the party has a duty to act with care. In a special relationship of reliance the information provider is specifically aware of and personally tailors information to the needs of the particular licensee as an integral part of the provider's primary business of providing such content. A reliance relationship does not arise for information made generally available to a group in standard form even if those who receive the information subscribe to the information service because they believe it relevant to their commercial or personal needs.

48. "**Receive**." This definition distinguishes between performances and notices. As to performances, it corresponds to Uniform Commercial Code § 2-103 (1998 Official Text). With respect to notices, "receive" includes circumstances in which a message is delivered to a place designated by the recipient even if that place is under the control of a third party. Arrival at a private post office box is receipt by the addressee even though the addressee may not remove or otherwise obtain the message until later. Similarly, receipt of a message at an electronic mail address, even though on a third party system, constitutes receipt as to the ultimate addressee, if that electronic mail address was held out as a place for receipt of such messages. The definition is met only if the person holds out a location or system as a place for receiving notices of a kind and the message is in fact of that kind. Outside of electronic commerce, parties frequently require that notice be delivered or sent to a particular address or person. The same is true in electronic commerce.

If parties agree to send notice of default or of a change in terms to a particular e-mail address, receipt at that location suffices, but delivery to a general e-mail address does not. In all cases, the message must be capable of being processed. This refers to processing in the type of system in its general, reasonably expected configuration and not to the details of an atypical configuration known or knowable only to the party operating the system. The message must be capable of interacting with an ordinary system of the particular type. Whether the message actually is processed is not relevant to receipt; similarly, if a letter is placed in a party's post office box it is received.

49. "**Record**." A record must be in, or capable of being retrieved in, perceivable form. Electronic text recorded in a computer memory that could be printed or displayed from that memory constitutes a record. Similarly, a tape recording of an oral conversation or a video taping of actions could be a record.

50. "**Release**." A release is a waiver or permission not accompanied by other commercial attributes, such as an on-going obligation to pay or an obligation to provide the means to implement use of the information. A release is a form of a license. The term is used in this Act to identify a class of transactions in which the sole purpose of the agreement is to permit use and which agreements are often made on a less formal basis than a typical commercial license.

51. "**Return**." "Return" refers to acts restoring a party to its initial position if the party has rejected a contract contained in a record made available to it after the party committed to, or completed, an obligation to pay or deliver and, as a result of rejecting the contract, the transaction will not be carried forward. A return requires re-delivery to the licensor or its agent of information already delivered that would have been covered by the rejected record. When the licensee is the party who rejects the contract, "return" consists of a reimbursement of fees paid on re-delivery of all copies of the information and documentation. In both cases, the information and documentation must be re-delivered in their original condition. Of course, by consent or by agreement the copies can be destroyed in accordance with instructions.

Return is not a remedy for breach. It is a right that arises under this Act or by agreement if a party refuses a proffered contract and it has previously committed to, or paid the contract fee. Making a return available in such cases allows the party a meaningful opportunity to decide to accept or reject that contract. Section 112. The right to return expires if the party assents to the license. Of course, if a

party accepts a contract but the information is defective, the aggrieved party may have a right to reject the product and obtain restitution of the contract fee.

Return must be sought within a reasonable time. What constitutes a reasonable time depends on the contract or, if the contract is silent, the facts and circumstances of the commercial context. Section 114.

The definition deals with the difficult problem of administering a return right in "bundled" information products (products that include separate items of information transferred as a whole for a single fee). Pricing in bundled transactions is not based on a mere sum of the fees required for each product in an unbundled setting and, often, include information products that are provided for no charge, even though the information may have a discernible price in other transactions.

If the products are separately priced, a return is for the contract fee for the item in question. Otherwise, return must be of the entire bundled product and reimbursement of the entire price, if any is attributed to the bundled software. For the former, the price must be separately stated in the sense that the agreement identified an amount for the particular information. A court cannot unbundle the products and estimate appropriate pricing in what is often a complex distribution arrangement premised on the bundling of multiple products.

52. "**Scope**." This term refers to contract terms that define the central elements of a license relating to aspects of use of the information. Scope provisions in a license define the product. In sales or leases of goods, products are self-defining: an offered car is either a Ford or Chevrolet, it is not necessary to read a contract to determine that. That is not the case in computer information. The same information has entirely different commercial characteristics depending on the scope of rights granted. For example, a license that allows use of a word processing program in a single computer is not the same product (even though the copy of the information may be exactly the same) as a license to make and distribute copies of that word processing software throughout a region. Further, neither license is the same as a license that transfers the a copy under a license to use it for three days at home. They are all different even though the software is identical, and in each case the differences can only be determined by reading the license.

53. "**Send**." This definition adapts Uniform Commercial Code § 1-201(38)(1998 Official Text) to cover electronic notices. In modern technology sending a message does not require that the information move from one location to another. Electronic transfers often involve initiating processes that copy the information into another location or make it available in a system shared or accessible by the recipient and the person or electronic agent creating the message. The message must be capable of being processed by the type of system involved.

It refers to the type of system in its general, reasonably expected configuration and not to the details of an atypical system configuration. Of course, if the sender has knowledge of the details of the actual system to which it is sending the message, its actions may need to take that knowledge into account. Use of the phrase "in addition" makes it clear that the electronic sending must also comply with relevant criteria for other media, such as in use of a commercially reasonable carrier. Finally, the message or item sent must be directed to a location or system that is held out as a place for receiving communications of that kind.

54. "**Standard form**." The definition refers to forms, not standard terms. A form consists of record containing a group of terms prepared for frequent use as a group. The definition does not cover a tailored contract comprised of "terms" selected from multiple prior agreements. The form must have been actually used without negotiation other than of the ordinarily tailored terms noted in the definition. If a standard form is offered but then negotiated or changed other than with respect to those ordinarily tailored terms, the resulting record of the contract is not a standard form.

55. "**Term**." This is from Uniform Commercial Code § 1-201(42) (1998 Official Text). The word refers to a discernible element of an agreement. The word "clause" has the same meaning in reference to an agreement.

56. "**Termination**." This is from Uniform Commercial Code § 2-106 (1998 Official Text). The effect of terminating a contract is discussed in Sections 616-618.

57. "Transfer." This word is used with respect to conveyances of contractual interests and refers to actual transfers of a contractual interest, as contrasted to agreements that merely employ another person to act on behalf of the transferor under a delegation or sublicense. Some of these transfers might be described as an assignment of the contract.

58. "**Usage of trade**." This is from Uniform Commercial Code 1-205 (1998 Official Text). This Act treats usage of trade as a factor in determining the commercial meaning of the agreement. The language used in a contract is interpreted as meaning what it may fairly be expected to mean to parties involved in the particular commercial transaction in a given locality or in a given vocation or

trade. This Act rejects cases which see evidence of "**custom**" as representing an effort to displace or negate "**established rule of law**."

A usage of trade must have the "regularity of observance" indicated in the text. It is not required that a usage of trade be "ancient or immemorial", "universal" or the like. Under this definition, full recognition is thus available for new usages and for usages currently observed by the majority of merchants, even though some do not. There is room also for appropriate recognition of usage agreed by merchants in trade codes.

59. *Subsection b.* Contains references to a variety of provisions of the Uniform Commercial Code which contain definitions of additional terms used in this Act. Unless otherwise expressly indicated, the reference is to the Official Texts of the respective provisions as of the end of 1998.

[subpart B. General Scope and Terms]

1-103. Construction of [Uniform Commercial Code] to Promote its Purposes and Policies: Applicability of Supplemental Principles of Law.

(a) [The Uniform Commercial Code] must be liberally construed and applied to promote its underlying purposes and policies, which are: (1) to simplify, clarify, and modernize the law governing commercial transactions; (2) to permit the continued expansion of commercial practices through custom, usage, and agreement of the parties; and (3) to make uniform the law among the various jurisdictions.

(b) Unless displaced by the particular provisions of [the Uniform Commercial Code], the principles of law and equity, including the law merchant and the law relative to capacity to contract, principal and agent, estoppel, fraud, misrepresentation, duress, coercion, mistake, bankruptcy, and other validating or invalidating cause supplement its provisions.

SCOPE; EXCLUSIONS; AGREEMENT THAT ACT GOVERNS.

Definitional Cross References. Section 102: "Agreement"; "Consumer"; "Computer"; "Computer information"; "Computer information transaction"; "Consumer"; "Copy"; "Electronic"; "Financial services transaction"; "Good faith"; "Goods"; "Information"; "License"; "Mass-market transaction"; "Party".

Official Comments:

1. *General Structure.* This section states the scope of coverage of this Act. Subsection (a) outlines the affirmative scope. Subsections (b) and (c) establish rules for transactions where more than one subject matter is involved. Subsection (d) sets forth exclusions from the Act. Subsection (e) defines "enhanced sound recording," a term used in subsection (d).

2. *Transactions in Computer Information.* This Act concerns contracts and not property rights. "Computer information transactions" are agreements that deal with the creation, modification access to, or distribution of computer information. Section 102(a)(11).

As stated in subsections (b) and (c), with limited exceptions, if a transaction is a computer information transaction but also involves other subject matter, this Act ordinarily applies only to the aspects of the transaction that involve "computer information." "Computer information" is information that is in a form directly capable of being processed by, or obtained from, a computer and any copy, associated documentation or packaging. Section 102(a)(10). Agreements can pertain to informational rights in computer information and this Act governs those contracts but does not create property rights. For example, subsection (b)(2) concerns transactions where computer information or informational rights are involved but are not the primary subject matter of the transaction. In such a case, this Act merely covers the part of the transaction involving contract issues pertaining to the computer information or rights, including all matters that can be addressed by contract and the contract's performance and enforcement, but does not pertain to the creation of property rights.

In transactions in computer information, the transferee seeks the information and contractual rights to use it. Unlike a buyer of goods, the purchaser (e.g., buyer, lessee, or licensee) of computer information has little interest in the original diskette or tape unless the information remains on that media and nowhere else. In online use and distribution, there may be no tangible media involved at all.

The scope of this Act turns initially on the definition of "*computer information transaction*." The mere fact that communications about a transaction are sent or recorded in digital form does not place it within this Act. Thus, a contract for airplane transportation is not a computer information transaction even though the ticket is in digital form. The subject matter is not the computer information, but the service – air transportation from one location to another. A contract to create and publish a print book is not a computer information transaction even though the author chooses or is required to deliver the work product in on a computer diskette. Similarly, an insurance policy prepared in digital form is not a computer information transaction; it is a contract for insurance coverage whose terms are evidenced in digital form. A contract for a digital signature certificate is a contract for certification or identification

services, not a contract whose subject matter is the computer information. This Act does not apply to the many cases in which a person provides information to another person for purposes of another transaction such as making an employment or loan application.

a. *Contracts to Create or Develop Computer Information.* This Act applies to contracts to develop or create software and other computer information, such as a computer database. Section 102(a)(11). Except as excluded in subsection (d), the Act covers all transactions involving independent contractors, thus resolving conflicts in prior case law. The Act does not cover contracts to develop or create motion pictures, sound recordings, or broadcast programs. These are excluded by subsection (d).

b. *Computer Programs.* This Act applies to transactions involving the distribution of, or grant of a right to use, a computer program. Section 102(a)(11). These transactions are covered whether they involve a license or a sale of a copy. The difference between a license and an unrestricted sale of a copy, however, is relevant; as reflected in various provisions of this Act, a license may involve either a more substantial retention of rights by the licensor, or a greater transfer of rights, than in a sale. Most provisions of this Act apply to unrestricted sales and licenses, but others are limited to licenses. The coverage of each section in this regard is explicit in the section.

c. *Access and Internet Contracts.* This Act covers agreements involving access to or information from a computer system. Section 102(a)(39). This includes Internet and similar systems for access to or use of computer information. The Act, however, does not cover broadcast or similar distribution of programming, or distribution of digital motion pictures, sound recordings or the like and should not be applied by analogy to such transactions. Section 103(d).

d. *Digital Multimedia Works.* This Act applies to agreements for the creation and distribution of digital multimedia works. Section 102(a)(11). Multimedia products are those which, through digital technology, involve an integration of multiple forms of authorship and multiple types of information into an integrated, often interactive work. Interactivity is a characteristic of software-based products. For a discussion of what a multimedia work is, see Copyright Office Circular (Multimedia Circular).

e. *Data processing Contracts.* This Act covers contracts for data processing or data analysis of computer information. Section 102(a)(39).

3. *Transactions outside the Act.* The scope of this Act is limited by the affirmative definitions of "computer information" and "computer information transaction," which exclude print and various other forms of information distribution, as well as by the exclusions stated in subsection (d). As a result, the Act leaves unaffected all transactions in the traditional core businesses of non-digital information industries (e.g., print, motion picture, broadcast, sound recordings). Whether a magazine (book or newspaper) publisher can contractually limit use of the information by purchasers of copies and what contract liability applies to print works is outside this Act, as are the following:

- **Sales or leases of goods**
- **Services contracts (except computer information development and support agreements)**
- **Casual exchanges of information**
- **Contracts where computer information is not required**
- **Employment contracts**
- **Contracts where computer information is insignificant (de minimus)**
- **Computers, televisions, VCR's, DVD players, or similar goods**
- **Print books, magazines, or newspapers**
- **Motion pictures, sound recordings, musical works**
- **Broadcast or cable programs.**

This Act does not apply to "information," but to contract transactions (agreements regarding information).

4. *Mixed Transactions.* A computer information transaction may involve computer information and other subject matter and thus present a question of whether all or any part of the transaction is governed by this Act, common law, or an article of the Uniform Commercial Code (U.C.C.) such as Article 2 and 2A. In modern commerce, most contracts are governed by multiple sources of contract law. The consequences of a contract to produce a motion picture or distribute it are governed by Article 2, the common law of services, common law relating to information, federal and state labor law, copyright and other intellectual property law. A sale of a toaster is governed by Article 2, common law, consumer law, and various federal regulations.

This Act does not **create** "mixed contracts." Since virtually all contracts of all types involve "mixed" law, the issue is not whether multiple sources of contract law apply, but to what extent this Act applies in lieu of another law. Subsections (b) and (c) tailor the answer to the issue presented, the type of transaction, and the applicable commercial policies. The primary distinction is between cases where the other subject matter is governed by articles of the Uniform Commercial Code (U.C.C.) and cases involving subject matter not governed by the U.C.C.

a. *Computer Information and U.C.C. Subject Matter.* Where a transaction includes computer information and subject matter governed by an article of the U.C.C., the policy expressed in this Act is that, in the absence of contrary agreement, the codified rules of the U.C.C. should apply to its subject matter and this Act should apply to its subject matter. That principle is express in subsection (d)(6). Thus, U.C.C. Article 8, and not this Act, deals with investment securities and rights or remedies with respect to them. The same applies for Articles 4 and 4A: payment systems, checks, and funds transfers. Similarly, subsection (c) indicates that if a provision of U.C.C. Article 9 conflicts with this Act, Article 9 controls.

The primary context in which this issue arises involves transactions that include goods, as defined for Article 2 and 2A, and computer information. "Goods" is defined Section 102(b). Generally there is no overlap since computer information and informational rights are not goods. See, e.g., *United States v. Stafford*, -- F.3d --, 1998 U.S. App. Lexis 1794 (7th Cir. 1998). If there is a diskette, it is a tangible object but the information on the diskette is not a good just as the information in a book is not goods or governed by the law of goods laws even if the binding is. This Act includes the media in which computer information is fixed within the definition of computer information, and thereby avoids any conflict with U.C.C. Article 2.

When a transaction involves goods and computer information (e.g., acquisition of a computer and software), in most cases Article 2 applies to the goods, but this Act applies to the computer information. Section 103(b)(1) expresses that rule. Some courts describe this rule as the "gravamen of the action" standard. Law applicable to any part of a transaction depends on whether the disputed issue pertains to the goods or to the computer information. Each governs its own subject matter.

As noted, there are two exceptions. First, the media (e.g., tape, diskette) that is the carrier of the computer information is within this Act. This Act applies to the copy, documentation, and packaging of the computer information; indeed, these are within the definition of computer information itself. See Section 102. They are mere incidents of the transfer of the computer information.

Second, in some cases, a computer program is embedded in and sold or leased as part of goods, such as a computer program that controls timing in a car. These cases may support a narrow exception to the gravamen of the action test. Subsection (b)(1) outlines how courts should approach cases where a computer program is embedded in and inseparable from goods that are sold or leased as goods. The approach to this issue in Uniform Commercial Code Article 9 (1998 Official Text) deals with applicability of creating and perfecting security interests under that statute and is not adopted here. The rules here center on the importance of the program and access to it in the transaction.

First: This Act applies to the computer program and the copy of it if the good in which the copy is embedded is a computer or a computer peripheral. The computer or peripheral often cannot function without the computer information (computer program). The computer information itself is important to the transaction and a commercial choice to distribute the program in embedded form, rather than in a form that requires loading into the computer or peripheral does not change the applicability of this Act. For example, the software for a medical imaging system that relies largely on software capabilities would be within this Act, whether the software is embedded in the system or loaded into it after purchase. Of course, this rule does not mean that this Act applies to the computer itself this Act only to the programs embedded in the computer or peripheral

Second: In other cases where a copy of a computer program is sold or leased as part of goods, this Act applies to the program and the copy of it if giving the buyer or lessee of the goods access to or use of the program is ordinarily a "material purpose" of this type of transaction. This looks at materiality in an objective sense, centered on transactions of the type, rather than the subjective goals or intent of the particular parties. Materiality focuses on the particular good in which the program is embedded, rather than the overall transaction as a whole. The test deals with ordinary "transactions in goods of the type." Thus, the fact that a particular program automated system is a small part of a transaction involving many other assets does not take it out of this Act if, as to that particular system, access to the program is a material aspect of the deal.

In determining whether using the program is a material purpose in obtaining the goods, courts should examine the overall context. Factors suggesting that access to or use of the program is material include the extent to which the program's capabilities is the dominant appeal of the product, the extent to which

negotiation focused on that capability, and the extent to which the agreement makes the program a separate focus for agreed terms. Materiality is ordinarily clear if the program is separately licensed as part of the transaction. On the other hand, the fact that ordinary functions of ordinary goods may rely on a program embedded in the goods does not indicate that program is governed by this Act. Thus, some functions of an automobile sold at retail may be operated by embedded programs; if the automobile's functionality rather than the program that operates the brakes is the purpose of the transaction, this Act would not apply. On the other hand, upstream contracts to develop or supply the program to the manufacturer are within this Act. Separately licensed programs for a digital camera that enable the camera to link to a computer are within the Act.

b. Computer Information and Subject Matter not Within U.C.C. If a computer information transaction also involves other subject matter and that other subject matter is not governed by the U.C.C., subsection (b)(2) states how to determine the extent of applicability of this Act. The basic rule is that this Act applies to aspects of the agreement concerning the computer information and informational rights but not to aspects involving the other subject matter unless, pursuant to subsection (b)(2), this Act applies because the computer information is the primary purpose of the agreement. In applying this rule, it is appropriate for courts to recognize that, unless the computer information is the primary purpose of the deal, the other subject matter will be covered by common law or other law, rather than a uniform statute.

Under subsection (b)(2) (in cases not involving U.C.C. subject matter), if computer information or informational rights is the primary purpose of a transaction, this Act applies to the entire transaction except subject matter excluded by subsection (d). Otherwise, under subsection (b)(2) this Act applies only to the contract issues pertaining to the aspect of the transaction involving computer information or rights.

Variations of this test have been used for years in cases involving a combination of goods and services. The test asks a court to consider whether the computer information or other subject matter (e.g., services) is the main focus. In doing so, the court should consider the type of transaction envisioned by the parties. While cases under Article 2 provide guidance on answering this kind of questions, it is appropriate to consider additional factors when this Act is contrasted to common law. Courts should consider the extent to which the transaction as a whole corresponds to the framework involved in computer information transactions, such as: 1) the nature of any underlying intellectual property rights involved, including differences in the rights provided for different types of works, 2) the extent to which regulatory rules outside this Act apply to the other subject matter, 3) the extent to which clear allocation of liability risk is a concern, and 4) the extent to which coverage by this Act of the other subject matter in the transaction will correspond to reasonable expectations of the parties as to how the legal issues should be handled.

The same test applies at various levels of use or distribution, but the results may differ at each level. For example, a courier company that licenses communications software from a software publisher is engaged in an transaction entirely within this Act. The subject matter is a license of software. If the courier company provides the software to customers to access data on the location of their packages, the primary purpose may have to do with the services the courier provides. Even then, however, if the software publisher enters into a license with the end user, as between the publisher and the end user, the license which is within this Act is the primary purpose of that agreement.

The statutory test in subsection (b)(2) applies only if the transaction is not entirely excluded under subsection (d). This means that the computer information is more than de minimus and not involved simply as a method of communicating about the contract.

The rules of subsection (b) do not apply if the agreement specifies what law governs. See Section 104. If the parties elect coverage under this Act, that agreement generally governs as would an agreement that this Act should not apply at all. Agreement here, as elsewhere, can be found in the express terms of the contract as well as in the usage of trade or course of dealing between the parties, or as inferred from the commercial circumstances of the contracting.

5. *Exclusions.* Subsection (d) states several exclusions from this Act. They are based on a judgment that rules in this Act should not apply to the excluded subject matter unless the parties so agree , because the excluded transactions are different in type. Ordinarily, a court should not apply this Act by analogy to excluded subject matter, but should refer to other law such as Article 2 or Article 2A of the Uniform Commercial Code or the common law.

a. *Core Financial Functions.* Subsection (d)(1) excludes core banking, payment and financial services activities. These are regulated by federal and state law and are largely within the scope of the U.C.C. The term, "financial services transaction" is defined in Section 102. This is an "activity" exclusion not an "entity" exclusion.. Regulations, such as federal Regulation E on funds transfer, do not apply solely to banks, but to any holder of a qualifying account. To the extent that non-banks engage in the activities indicated in the exclusion, those activities are also excluded from this Act (whether

conducted by a bank or a non-bank). On the other hand, banks engage in many activities identical to computer information transaction and these transactions, when not covered by this exclusion, are within this Act. Examples could be contracts involving on-line shopping and database access.

b. *Core Entertainment and Broadcast.* Subsection (d)(2) excludes agreements relating to motion pictures, musical works, sound recordings, enhanced sound recordings, and broadcast and cable programming. The exclusion covers the traditional core activities of these industries or, in the case of enhanced sound recordings, a slightly enhanced version of a traditional activity. It is intended to be comprehensive as to those core activities and reflects the existence of a regulatory overlay for some (cable and broadcast) and the different nature of transactional issues as contrasted to computer information industries. The exclusion of agreements pertaining to motion pictures, sound recordings, and the listed broadcast or cable activities leaves liability, contract formation, and other issues to general law, including Article 2 or Article 2A of the Uniform Commercial Code, as applicable. Because these transactions differ from those within this Act, this Act should not be applied by analogy to transactions in these areas of practice.

The terms "motion picture", "sound recording", "musical work", and "phonorecord" have the meanings associated with those terms in the Copyright Act as of the indicated date. The exclusion includes creation or distribution of these works in digital form. The Copyright Act and the registration system it enacts makes distinctions among and between various types of works, such as audiovisual works, literary works, computer programs, motion pictures, and sound recordings. These distinctions are followed here. The exclusion additionally employs a new term, "enhanced sound recording", to cover digital products that have elements slightly beyond ordinary sound recordings (e.g., a program to allow use of the work), but which do not change the fundamental nature of the work as a sound recording.

"Motion picture" includes motion pictures regardless of how distributed, even in digital form. These products are not governed by this Act and either Article 2 or Article 2A, along with common law, apply. For purposes of this Act, the term "motion picture" does not include an interactive computer game, multimedia product, or similar work, nor does it include audio visual effects included in such interactive works. The term refers to the work as a whole and not images or visual motion within another work or within software, such as the animated help feature of a word processing program or images or motion in an interactive computer encyclopedia.

Subsection (d)(2) excludes contracts for audio and visual programming distributed by broadcast, cable, or satellite regardless of whether transmitted in digital or another form, including transmissions analogous to broadcast made through the Internet. The federal Communications Act and associated regulations define the terms associated with this exclusion and the intent is to adopt that terminology as of the indicated date.

c. *Compulsory Licenses.* Subsection (d)(3) excludes compulsory licenses, such as that provided under the Copyright Act. These transactions, as the term implies, are not voluntary contractual relationships and the contract choice principles which underlie this Act are not appropriate.

d. *Employment Contracts.* This Act does not deal with employee contracts. A vast network of labor law and other regulatory rules apply to the relationship between an employee and employer and the intent in this Act is to leave that existing law unchanged.

e. *Voluntary Use of Computer Information.* Under Subsection (d)(5) an agreement is not within brought into this Act merely because one party elects to use computer information to transmit information to the other, when not required to do so. For example, an author that contracts to submit an article to a publisher for publication in a print journal and elects to send the submission by E-mail does not thereby bring the contract into this Act. A developer required to deliver information in a form other than as computer information, does not bring the transaction within this Act merely by electing to develop the product using digital systems.

f. *Form is Insignificant.* This Act generally applies a gravamen of the action approach for when this Act applies to its subject matter and other law governs other subject matter in one transaction. However, there may be cases in which the form of the information as computer information is such a minor part of the transaction that the Act should not apply. Subsection (d)(5) provides a court with the basis to reach this judgment if the form of the information as computer information is insignificant (de minimis) to the deal. This is a narrow exception to the general rule, applicable where the form of the information as computer information is a trivial part of the relationship. This exception does not ask a court to contract the allocated cost of the computer information to the overall cost of the transaction. What must be insignificant is the fact that the information is provided in the form of computer information. If it could not be provided in any other way and still fulfill its role in the transaction, as where the computer information is an operating computer program system, its form can never be insignificant.

1-104. Construction Against Implied Repeal.

[The Uniform Commercial Code] being a general act intended as a unified coverage of its subject matter, no part of it shall be deemed to be impliedly repealed by subsequent legislation if such construction can reasonably be avoided.

AGREEMENT THAT ACT GOVERNS

Definitional Cross-References: Section 102: "Agreement"; "Computer"; "Computer Information"; "Computer program"; "Conspicuous"; "Copy"; "Good faith"; "Goods"; "Information"; "Informational rights"; "Mass-market transaction"; "Party".

1. *Scope of Section.* This section adopts the basic rule that, generally, parties can agree to have this Act apply to an entire transaction, part of a transaction, or none of it. This rule, of course, deals with applicability of this Act and not other law, including law that supplements this Act.

2. *General Rule.* This section expressly acknowledges a contractual capability that has been assumed to exist under general law. The capability to opt into or out of a contract statute is important in this Act because the narrow scope of this Act may create uncertainty or differences in coverage that the parties should be able to avoid by agreement.

Under this section, parties can agree to apply or to bar application of this Act if a material part of the transaction involves computer information or subject matter excluded under Section 103 (d)(1) or (d)(2). The materiality requirement should be liberally construed to enable agreements. It does not establish a standard relating solely to relative cost or value or a standard that asks a court to determine what is the most significant or primary part of a transaction, but merely whether the computer information or otherwise excluded information has some significance to the transaction. Materiality is not met if the computer information is a trivial or otherwise insignificant aspect of the transaction. Failure to meet the materiality requirement does not preclude an agreement being enforceable under other law, but any agreement to opt-in or opt-out is governed by the limitations stated in subsections (1) to (5). Failure to meet the materiality standard does not it indicate that parties cannot otherwise alter the effect of any contract rule under this Act or other law by agreement, if the rule is variable by agreement.

In determining whether an enforceable agreement was formed, a court should apply the contract formation rules of this Act since a material part of the agreement involves computer information. Agreement can be found in the express terms of the contract, in course of dealing, usage of trade, or as inferred from the circumstances. In a mass-market transaction, a term of an agreement to opt-in or to opt-out of the Act under subsection (3) must be conspicuous.

3. *Limitations on Right.* Subsections (1) through (5) place limitations on an agreement to opt into or out of this Act.

a. Opt-In Agreements: General. Subsection (1) deals with agreements that provide that this Act governs aspects of a transaction to which it would not otherwise apply ("opt-in agreements"). It confirms the applicability of any rules in other law that reflect a policy that the effect of the rule cannot be varied by agreement or that restrict what procedure must be used to vary the rule. Of course, for this limitation to apply, the non-variable rule must be applicable to the transaction in the absence of the opt-in agreement.

In addition, an agreement to opt-in to this Act cannot alter the effect of otherwise applicable consumer protection statutes or of a law dealing with rights in a copy of printed information (e.g., a book on paper) distributed in the mass market. In each of case, the policy is that the idea of contract choice should not apply in the face of important, expressed policies of the state. A consumer protection statute is a provision of a statute that applies specifically to consumers and creates a more protective rule for the consumer than for other parties in similar transactions.

b. Opt-In Agreements: Embedded Programs. Subsection (4) follows the exclusion stated in Section 103 for some computer programs embedded in goods. If a computer program is excluded from coverage of this Act the parties cannot use the program to bring the goods in which the program is embedded into the Act. Thus, under Section 103(b), this Act does not apply to a car or to a copy of a computer program regulating the brakes of the car and sold or leased as part of the car. With respect to the car and program, the parties could not opt into this Act. The result would be different if the embedded program is within this Act under Section 103.

c. U.C.C. Rules. Under subsection (5) an agreement to opt-in to this Act cannot alter rules stated in the indicated articles of the Uniform Commercial Code. This refers to rules specifically dealt with in those parts of the Commercial Code, not the general subject matter of the UCC. The agreement can, for example, affect contract formation and other principles to the extent not dealt with by specific rules in those articles.

d. Opt-out Agreements. Subsection (2) concerns agreements to opt-out of coverage by this Act. An agreement to opt-out places the transaction within other contract law as to the portion of the

transaction to which this Act would otherwise apply. Recognizing this, subsection (2) places only limited restrictions on what aspect of this Act can be altered by virtue of that type of agreement.

4. *Other Limitations.* In addition to the limitations stated in this section, an agreement to opt in or opt out of coverage by this Act is governed by general standards of unconscionability and good faith.

1-105. Severability.

If any provision or clause of [the Uniform Commercial Code] or its application to any person or circumstance is held invalid, the invalidity does not affect other provisions or applications of [the Uniform Commercial Code] which can be given effect without the invalid provision or application, and to this end the provisions of [the Uniform Commercial Code] are severable.

RELATION TO FEDERAL LAW; TRANSACTIONS SUBJECT TO OTHER STATE LAW. Uniform Law

Source: Uniform Commercial Code 9-104(1)(a); 2A-104(1) (1998 Official Text) **Definitional Cross References:** Section 102: "Agreement"; "Authenticate"; "Conspicuous"; "Consumer"; "Contract"; "Electronic"; "Information"; "Informational Rights"; "Record"; "Term".

Official Comments:

1. *General Principle and Scope of the Section.* Subsections (a) and (b) clarify that this Act does not alter intellectual property or other fundamental information laws. Subsection (c) states a similar principle for consumer protection statutes subject to the narrow electronic commerce rules in subsection (d).

The transition from print to digital media created new demands for information. Because digital information is so easily copied, increased attention has been focused on the formulation of rights in information in order to encourage its creation and on the development of contracting methods that enable effective development and efficient marketing of information assets. Here, as in other parts of the economy, the fundamental policy of contract law is to enforce contractual agreements. At the same time, there remains a fundamental public interest in assuring that information in the public domain is free for all to use from the public domain and in providing access to information for public purposes such as education, research, and fair comment. While the digital environment increases the risk of unfair copying, the enforcement of contracts that permit owners to limit use of information and the development of technological self-help measures have given the owner of information considerable means of enforcing exclusivity in the information they produce or collect. This is true not only against those in contractual privity with the owner, but also in some contexts against the world-at-large.

The effort to balance the rights of owners of information against the claims of those who want access is very complex and has been the subject of considerable controversy and negotiation at both the federal level and internationally. The extent to which the resolution of these issues at the federal level ought to preempt state law is beyond the scope of this Act, the central purpose of which is to facilitate private transactions in information. Moreover, it is clear that limitations on the information rights of owners that may be imposed in a copyright regime where rights are conferred that bind third parties, may be inappropriate in a contractual setting where courts should be reluctant to set aside terms of a contract. Subsections (a) and (b) strike the balance between fundamental interests in contract freedom and fundamental public policies such as those regarding innovation, competition, and free expression. The use of these general principles will enable the courts to react to changing practices and technology, while specific prohibitions would lack flexibility and would inevitably fail to cover all relevant contingencies.

2. *Federal Law: Preemption.* Subsection (a) restates a rule that would apply in any event. If federal law invalidates a state contract law or contract term in a particular setting, federal law controls. See, e.g., *Everex Systems, Inc. v. Cadtrak Corp.,* 89 F.3d 673 (9th Cir. 1996) (patent license not transferable); *Harris v. Emus Records Corp.*, 734 F.2d 1329 (9th Cir. 1984) (copyright license not transferable); *Rano v. Sipa Press, Inc.*, 987 F2d 580 (9th Cir. 1993) (copyright preempts rule on licenses terminable at will); *SOS, Inc. v. Payday, Inc.,* 886 F.2d 1084 (9th Cir. 1989) (federal policy controls over state contract law interpretation rules; interpretation must protect the rights-holder).

Subsection (a) refers to preemptive federal rules, but other doctrines grounded in First Amendment, copyright misuse and other federal law may preempt enforcement of some contract terms in some cases. In general, however, except for rules that directly regulate specific contract terms, no general preemption of contracting arises under copyright or patent law. See *National Car Rental System, Inc. v. Computer Associates Int'l, Inc.*, 991 F2d 426 (8th Cir. 1993); *ProCD Inc. v. Zeidenberg*, 86 F.3d 1447 (7th Cir. 1996). No effort is made in this Act to define whether or to what extent such a preemption may arise.

3. *Public Policy Invalidation.* Contract terms may be unenforceable because of federal preemption under subsection (a) of this section or because the term is unconscionable under section 111. In addition, subsection (b) acknowledges the general legal principle that, in certain limited circumstances, terms may be unenforceable because they violate a fundamental public policy that clearly overrides the policy favoring enforcement of private transactions as between the parties. The principle that courts may invalidate a term of a contract on public policy grounds is recognized at common law and in the *Restatement (Second) of Contracts* § 178 et. seq. It is a supplementary legal principle incorporated under Section 1-103 and applies to all contract law and all articles of this Code. Subsection (b) is designed to clarify the nature of the policies that have particular relevance to the subject matter governed by this Act.

Fundamental state policies are most commonly stated by the legislature. In the absence of a legislative declaration of a particular policy, courts should be reluctant to override a contract term. In evaluating a claim that a term violates this subsection, courts should consider a variety of factors including the extent to which enforcement or invalidation of the term will adversely affect the interests of each party to the transaction or the public, the interest in protecting expectations arising from the contract, the purpose of the challenged term, the extent to which enforcement or invalidation will adversely affect other fundamental public interests, the strength and consistency of judicial decisions applying similar policies in similar contexts, the nature of any express legislative or regulatory policies, and the values of certainty of enforcement and uniformity in interpreting contractual provisions. Where the parties have negotiated terms of their agreement courts will be even more reluctant to set aside terms of the contract. In light of the national and international integration of the digital environment, courts should be reluctant to invalidate terms based on purely local policies.

In applying these , courts should consider the position taken in the *Restatement (Second) of Contracts 178, comment b* ("In doubtful cases … a decision as to enforceability is reached only after a careful balancing, in light of the circumstances, of the interests in the enforcement of the particular promise against the policy against the enforcement of such terms. … Enforcement will be denied only if the factors that argue against enforcement clearly outweigh the law's traditional interest in protecting the expectations of the parties, its abhorrence of any unjust enrichment, and any public interest in enforcement of the particular term.").

The public policies most likely to be applicable to transactions within this Act are those relating to innovation, competition, and fair comment. Innovation policy recognizes the need for a balance between conferring property interests in information in order to create incentives for creation and the importance of a rich public domain upon which most innovation ultimately depends. Competition policy prevents unreasonable restraints on publicly available information in order to protect competition. Rights of free expression may include the right of persons to comment, whether positively or negatively, on the character or quality of information in the marketplace.

In practice, enforcing private contracts is most often consistent with these policies, largely because contracts reflect a purchased allocation of risks and benefits and define the commercial marketplace in which much information is disseminated and acquired. Thus, a wide variety of contract terms restricting the use of information by one of the contracting parties present no significant concerns. For example, contract restrictions on libelous or obscene language in an on-line chat room promote interests in free expression and association and such restrictions are enforced to a much broader degree arising out of contractual arrangements than if imposed by governmental regulation. However, there remains the possibility that contractual terms, particularly those arising from a context without negotiation may be impermissible if they violate fundamental public policy.

Contracting parties may have greater freedom contractually to restrict the use of confidential information than information that is otherwise publicly available. While a term that prohibits a person from criticizing the quality of software may raise public policy concerns if included in a shrink-wrap license for software distributed in the mass-market, a similar provision included in an agreement between a developer and a company applicable to experimental or early version software not yet perfected for the marketplace would not raise similar concerns. Trade secret law allows information to be transferred subject to considerable contractual limitations on disclosure which facilitates the exploitation and commercial application of new technology. On the other hand, trade secret law does not prohibit reverse engineering of lawfully acquired goods available on the open market. Striking the appropriate balance depends on a variety of contextual factors that can only be assessed on a case-by-case basis with an eye to national policies.

A term or contract that results from an agreement between commercial parties should be presumed to be valid and a heavy burden of proof should be imposed on the party seeking to escape the terms of the agreement under subsection (b). This Act and general contract law recognizes the commercial necessity of also enforcing mass market transactions that involve the use of standard form agreements. The terms of such forms may not be available to the licensee prior to the payment of the price and typically are not subject to affirmative negotiations. In such circumstances, courts must be

more vigilant in assuring that limitations on use of the informational subject matter of the license are not invalid under fundamental public policy.

Even in mass market transactions, however, limitations in a license for software or other information such as terms that prohibit the licensee from making multiple copies, or that prohibit the licensee or others from using the information for commercial purposes, or that limit the number of users authorized to access the information, or that prohibit the modification of software or informational content without the licensor's permission are typically enforceable.

See, e.g., *Storm Impact, Inc. v. Software of the Month Club*, 13 F.Supp.2d 782 (N.D. Ill. 1998) ("no commercial use" restriction in an on-line contract). On the other hand, terms in a mass-market license that prohibit persons from observing the visible operations or visible characteristics of software and using the observations to develop non-infringing commercial products, that prohibit quotation of limited material for education or criticism purposes, or that preclude a non-profit library licensee from making an archival copy would ordinarily be invalid in the absence of a showing of significant commercial need.

Under the general principle in subsection (b), courts also may look to federal copyright and patent laws for guidance on what types of limitations on the rights of owners of information ordinarily seem appropriate, recognizing, however, that private parties ordinarily have sound commercial reasons for contracting for limitations on use and that enforcing private ordering arrangements in itself reflects a fundamental public policy enacted throughout the Uniform Commercial Code and common law.

In part because of the transformations caused by digital information, many areas of public information policy are in flux and subject to extensive debate. In several instances these debates are conducted within the domain of copyright or patent laws, such as whether copying a copyrighted work for purposes of reverse engineering is an infringement.

This Act does not address these issues of national policy, but how they are resolved may be instructive to courts in applying this subsection. The most recent national statement of policy on the relationship between reverse engineering, security testing, and copyright in digital information creates an express treatment of reverse engineering and security testing in connection with circumventing technological measures that limit access to copyrighted works. It recognizes a policy to not prohibit some instances of reverse engineering in cases where it is needed to obtain interoperability of computer programs.

17 U.S.C. 1201 (f) (1999) ("a person who has lawfully obtained the right to use a copy of a computer program may circumvent a technological measure … for the sole purpose of identifying and analyzing those elements of the program that are necessary to achieve interoperability of an independently created computer program with other programs, and that have not previously been readily available to the person engaging in the circumvention, to the extent any such acts of identification and analysis do not constitute infringement under this title.").

It further recognizes a policy to not prohibit security testing where it is needed to protect the integrity and security of computers, computer systems or computer networks. 17 U.S.C. 1201(j)(1999) ("the term `security testing' means accessing a computer, computer system, or computer network, solely for the purpose of good faith testing, investigating, or correcting, a security flaw or vulnerability, with the authorization of the owner or operator of such computer, computer system, or computer network … [It] is not a violation … for a person to develop, produce, distribute or employ technological means for the sole purpose of performing the acts of security testing…"). This policy in many circumstances may outweigh a contract term to the contrary.

With reference to contract law policies that regulate the bargain of the parties, this Act makes express public policy choices. Contract law issues such as contract formation, creation and disclaimer of warranties, measuring and limiting damages, basic contractual obligations, contractual background rules, the effect of contractual choice, risk of loss, and the like, including the right of parties to alter the effect of the terms of this Act by their agreement should not be invalidated under subsection (b) of this section. This subsection deals with policies that implicate the broader public interest and the balance between enforcing private transactions and the need to protect the public domain of information.

The court, if it finds a particular term unenforceable under this section, may enforce the remainder of the contract if it is possible to do so. In considering this issue the court should consider the factors described in *Restatement (Second) of Contracts §*184.

4. *State Law: Consumer Statutes.* This Act generally does not alter state consumer protection statutes or, if the state chooses to so state, administrative rules. This recognizes the independent role of state consumer protection statutes and the diversity that exists nationally in those statutes. A statute can be fairly described as a consumer protection statute or a provision thereof only if contains

protections or rights specifically earmarked for consumers, but such provisions may be embodied in other statutes such as the Uniform Commercial Code..

This Act deals with general contract and commercial law principles. It does not promulgate a consumer protection code, although the Act does contain numerous consumer protections. Historically, consumer protection law has been defined on a state-by-state basis. This Act, as a general commercial statute, does not override these judgments. With the exception of the limited procedural rules in subsection (d), a state's consumer protection statutes [or regulations] trump the general contract law of this Act. Thus, for example, a consumer protection statute that regulates advertising, mandates disclosure of the licensor's main business office, requires disclosure of a term in specified content, manner, typeface or the like, provides for recovery of treble damages for particular types of breach, or limits disclaimers of warranty in a consumer contract, are not altered by this Act. Similarly, this Act does not alter the scope of coverage of any existing consumer statute since that scope is determined by the consumer protection statute itself. If the statute could reasonably be interpreted as applying to computer information transactions, it would be within this subsection (c).

5. *State Law: Electronic Commerce Issues.* Subsection (d) provides for limited displacement of other state law on several electronic commerce issues, shifting those requirements to standards consistent with the electronic commerce treatment in this Act. This approach parallels the treatment of this issue in digital signature laws and in electronic signature legislation, and is appropriate and necessary to facilitate the cost savings and expanded access to information that electronic commerce offers. The rules are limited to transactions within this Act. For computer information transactions generally, this Act supplants other law as to contract issues and this section merely reflects that. For consumer transactions, substantive statutes inconsistent with or in addition to those of this Act, such as the content, timing, and manner of a disclosure or warning, are preserved. As to four stated electronic commerce rules, however, this Act selectively replaces limited procedural rules but does not otherwise alter the substantive terms of the consumer law.

Subsection (d)(1) allows an electronic record to suffice for a writing required in a transaction within this Act. This assumes that the form and presentation of material and disclosures in the record otherwise meets the substantive requirements of the relevant other statute. For example, in some cases, a consumer protection statute requires that the consumer be able to retain the writing; this subsection does not alter that requirement. Similarly, in some consumer statutes requiring a writing, the requirement is that the consumer actually initial particular terms of the record. Subsection (d) does not alter that rule (although under other paragraphs of subsection (d), electronic "initials" can suffice for handwritten initials); the record that substitutes for a writing must be meet the other underlying requirements.

Similarly, subsection (d)(2) states that an authentication under this Act satisfies requirements of a signature if given for the purposes and in the context associated with the requirements of the other law.

Subsection (d)(3) updates the concept of conspicuousness when used, but not otherwise defined, in other law. The update reflects the electronic commerce themes adopted in this Act. This rule does not, of course, affect other type of disclosure rule. For example, a consumer protection rule which requires disclosure before a transaction occurs is not affected. Similarly unaffected is any rule that refers to the content of the required disclosure or which regulates the specific timing, form or manner in which it must be made. This over-ride does not apply to statutes that relate to advertising or the like – such statutes are not within the scope of this Act or are preserved.

6. *Digital And Electronic Signature Statutes.* Subsection (e) allows states with existing laws regarding digital signature, electronic signatures, and other similar statutes that apply or attribute acts of performances of a party in computer information transactions, to list any provisions of such statutes that the State that will prevail over this Act in the case of a conflict. For example, it is likely that such statutes do not provide a consumer defense to electronic errors of the type provided in Section 216 of this Act but instead simply attribute a contract made in compliance with statutes to the consumer regardless of error. If a State wishes to afford consumers the protections of Section 216, it should not list its other statutes. It is not necessary to list the Uniform Electronic Transactions Act because, by its terms, that act does not apply if UCITA applies.

1-106. Use of Singular and Plural; Gender.

In [the Uniform Commercial Code], unless the statutory context otherwise requires: (1) words in the singular number include the plural, and those in the plural include the singular; and (2) words of any gender also refer to any other gender.

Rules of Construction.

Uniform Law Source: Uniform Commercial Code 1-102(1)(2)(4).

Definitional Cross References: Section 102: "Agreement"; "Computer Information transaction"; "Conspicuous"; "Contract"; "Electronic"; "Party"; "Term".

Official Comments:

1. *Scope of the Section.* This section brings together rules regarding construction and application of this Act.

2. *Purpose of the Act.* This Act must be construed in light of its purposes, as stated in paragraph (1). They are not regulatory, but are intended to facilitate and support commercial practice and to support its evolution through agreement and trade practices. To construe an act in light of its purposes does not mean that the general purposes supplant its specific provisions. However, in cases of uncertainty, the meaning of this Act should be construed by reference to the stated purposes and the themes developed in the Act, as opposed to inconsistent or extraneous contract law policies that contradict those of this Act.

3. *Mandatory Language.* This Act ordinarily does not use phrases such as "unless otherwise agreed" and frequently uses mandatory language such as "shall" or "must." Neither drafting style alters the basic rule that the agreement controls in all cases, except as indicated in Section 113(a). Paragraph (2) rejects decisions such as *Suburban Trust and Savings Bank v. The University of Delaware,* 910 F. Supp. 1009 (D. Del. 1995).

4. *Negative Inference.* Paragraph (3) resolves issues about the existence of a negative pregnant. In this Act, the statement of an affirmative result that occurs when certain conditions are met does not necessarily indicate that a different result occurs if the conditions are not met. Thus, if a provision states: "If the originator of a message requests acknowledgment, the following rules apply: ---", this does not indicate what rule governs in the absence of a request. Similarly, a provision that states that particular language or procedure yields a specific result does not indicate what result occurs with different language or procedure. It merely states the affirmative proposition. If a different interpretation is intended, that different interpretation is made explicit in the section.

1-107. Section Captions.

Section captions are part of [the Uniform Commercial Code].

LEGAL RECOGNITION OF ELECTRONIC RECORD AND AUTHENTICATION; USE OF ELECTRONIC AGENTS.

Definitional Cross References: Section 102: "Agreement"; **"**Authentication"; "Electronic"; "Electronic agent"; "Person"; "Record"; "Receive"; "Sent". Section 112: "Manifestation of assent".

Official Comments:

1. *Scope of Section.* This section states several fundamental principles relevant to enabling electronic commerce in computer information. The rules apply only to transactions within this Act and do not directly pertain to other transactions or to subject matter excluded under Section 103, such as transactions involving motion pictures and sound recordings.

2. *Equivalence of Electronics.* Subsection (a) is an express recognition that the fact that a message, record or authentication is electronic does not alter its legal impact. This equivalency refers to the form of the authentication or record, and not to its content. See also Section 105(d). Subsection (a) merely states an affirmative legal principle: it does not address questions of proof or attribution of the record or authentication. In particular, the subsection does not alter evidence rules relating to when an original copy of a record is required or what, in a digital world, constitutes an original.

3. *Requiring Electronics.* Subsection (b) makes clear that nothing in this Act requires parties to use electronic processes. In some cases, the parties may wish to require traditional writings and this Act does not disturb that choice. It merely builds the proper legal framework for electronic commerce, consisting of a legal regime in which electronics and paper records are equivalent in law. Parties may determine to use, or not to use, that framework.

4. *Establishing requirements.* Consistent with the idea of contractual freedom and personal choice, subsection (c) makes it clear that parties can set their own requirements regarding records or authentication that are acceptable to them. They are not required to deal electronically or to accept an electronic record or authentication. This principle, of course, does not authorize one party unilaterally to change requirements that were established by an agreement between the parties.

On the other hand, the principle does not require the parties to establish requirements or make an agreement regarding same – the section simply clarifies that they are free to do so if they so choose. Subsection (c) also recognizes that a person can insist on conformance with requirements that are offered or agreed. Thus, while typing one’s name with the requisite intent may suffice as an authentication, parties are free to require a different form of authentication, such as a digital signature

utilizing public/private key encryption. Nothing in this Act disturbs that ability to so contract. Ordinary standards of waiver, estoppel and the like, along with general rules of offer and acceptance provide standards for dealing with issues that might arise in this context.

5. *Electronic Agents.* Subsection (d) states the general principle that operations of an electronic agent bind the party that used the agent for that purpose. This is limited to situations where the party selects the agent, a concept which covers the case where the party consciously elects to employ the agent on its own behalf, whether that agent was created by it, licensed from another, or otherwise adopted for this purpose.

Electronic agents enable important reduction in transactional costs and broaden the ability to search and interact with the myriad sites found on the Internet and similar systems. The concept stated here embodies principles like those in ordinary agency law. The electronic agent must be functioning within its intended purpose. For human agents, this is often described in terms of whether the agent acted within the scope of its authority. Here, since we deal with automation, the focus is more accurately placed on whether the agent was used for the relevant purpose. For a similar concept in a different context, see *Playboy Enterprises, Inc. v. Webbworld, Inc.,* 991 F. Supp. 543 (N.D. Tex. 1997). Cases of fraud, manipulation and the like are discussed in Section 206.

1-108. Relation to Electronic Signatures in Global and National Commerce Act.

This article modifies, limits, and supersedes the federal Electronic Signatures in Global and National Commerce Act, 15 U.S.C. Section 7001 et seq., except that nothing in this article modifies, limits, or supersedes Section 7001(c) of that Act or authorizes electronic delivery of any of the notices described in Section 7003(b) of that Act.

PROOF AND EFFECT OF AUTHENTICATION.

Definitional Cross References. Section 102: "Attribution procedure"; "Authenticate"; "Information"; "Party"; "Record".

Official Comments:

1. *Scope of the Section.* This section deals with two issues pertaining to proof of an authentication. It does not directly address to whom the authentication is attributed.

2. *Method of Proof.* Proof of authentication can occur in any manner. In the anonymous world of electronic commerce, one of the most important means of proving authentication is by showing that a process existed that required an authentication in order to proceed in an automated system. To satisfy the idea of authentication, however, it is not sufficient merely to show that some act was required to proceed. The act required to do so must constitute an authentication.

3. *Authentication Procedure.* Under Subsection (b), compliance with a commercially reasonable procedure for authentication removes questions about whether an authentication was intended or occurred. This is true both because the procedure is commercially reasonable and because the parties have adopted or agreed to using the procedure for that purpose. The attribution procedure must be one for authenticating a record and must be complied with. Compliance with such a procedure does not necessarily resolve issues regarding to whom the authentication is attributed, but obviously has some weight on that question. See Section 213. On whether an attribution procedure is commercially reasonable, see Section 212.

1-109. CHOICE OF LAW.

Uniform Law Source: Restatement (Second) of Conflicts 188. Revised.

Definitional Cross References. Section 102: "Access contract"; "Agreement"; "Consumer"; "Consumer contract"; "Contract"; "Copy"; "Delivery"; "Electronic"; "Licensor"; "Party"; "State"; "Term".

Official Comments:

1. *Scope of Section.* This section deals with the enforceability of a contract term selecting applicable law and with what law applies in the absence of such terms. Subsection (a) honors an agreement by the parties, but establishes a consumer protection rule. Subsection (b) and (c) provide needed certainty for electronic commerce on what law applies in the absence of a contract term.

2. *Contractual Choice of Law.* Contract terms that select law applicable to the contract are routine in commerce. The information economy accentuates their importance because it allows remote parties to enter and perform contracts using systems spanning multiple jurisdictions and operating in circumstances that do not depend on physical location of either party or the information. The rule in subsection (a) enables small entities actively to engage in multi-national business; if an agreement cannot designate applicable law, even the smallest business could be subject to the law of all fifty states and all countries in the world. That would impose substantial cost and uncertainty on an

otherwise efficient system and raise barriers to entry. This section is critical to the electronic commerce rules in this Act.

a. General Rule. This Act generally provides for enforcement of choice of law agreements in commercial contracts. This follows the rule adopted in a majority of decisions dealing with information-related contracts. See *Medtronic Inc. v. Janss*, 729 F.2d 1395 (11th Cir. 1984); *Northeast Data Sys., Inc. v. McDonnell Douglas Computer Sys. Co.*, 986 F.2d 607 (1st Cir. 1993). The *Restatement (Second) of Conflict of Laws* § 188 has a similar rule, validating contract terms as to all issues that can be resolved by agreement and even validating many agreements as to otherwise non-waivable terms in many cases. Subsection (a) does not follow U.C.C. 1-105 (1998 Official Text) which permits contract choices only if the selected law is of a jurisdiction with a "reasonable relationship" to the transaction. In a global information economy, limitations of that type are inappropriate, especially in cyberspace transactions where physical locations are often irrelevant or not knowable. Also, in global commerce parties may intentionally and appropriately wish to select a neutral forum because neither is familiar with the law of the other's jurisdiction. In such a case, the chosen law may have no relationship at all to the transaction – that is why it was chosen. *See, e.g.,* White House Report, *A Framework for Global Electronic Commerce*, July 1, 1997, ("The U.S. should work closely with other nations to clarify applicable jurisdictional rules and to generally favor and enforce contact provisions that allow parties to select substantive rules governing liability.").

b. Limitations. Contractual choice of law terms are subject to this Act's general limitations on terms such as the doctrine of unconscionability, which might exclude a term that unreasonably makes a highly prejudicial choice of law in a contract of adhesion. Also, some agreed terms may be unenforceable under the overriding fundamental public policy of the forum state. Section 105(b). See *Application Group, Inc. v. Hunter Group, Inc.*, 61 Cal. App.4th 881, 72 Cal. Rptr.2d 73 (Cal. App. 1998). Compare *Lowry Computer Products, Inc. v. Head*, 984 F. Supp. 1111 (E.D. Mich. 1997).

Subsection (a) creates a new, additional limit on these contract terms, providing that, in a consumer contract, the agreed choice of law cannot override an otherwise applicable rule which could not be altered by agreement under the law of the state whose law would apply in the absence of the contractual choice. This rule will impose significant costs on Internet commerce, but the policy here is that the fundamental policy of freedom of contract should not permit overriding the consumer rule if a state, having addressed the cost and benefits, determines that the consumer rule is nonwaivable.

3. *Choice of Law: no contract term.* Subsection (b) states the choice-of-law rules that govern in the absence of a contract term. Contracts in computer information can be created and performed remotely, a factor encouraging the need for tailored and understandable rules that enhance certainty and thus facilitate global commerce. As to general common law, see *William Richman & William Reynolds, Understanding Conflict of Laws* 241 (2d ed. 1992) ("[C]hoice-of-law theory today is in considerable disarray… [It] is marked by eclecticism and even eccentricity.").

Subsection (b)(1) deals with electronic commerce. It is especially important to have consistent rules among the states. Subsection (b)(1) specifies that in an access contract or a contract involving electronic delivery of information, the agreement is governed by the law of the jurisdiction in which the licensor is located (in the absence of a contract term). "Located" is defined in subsection (d). This rule enhances certainty in a transactional context where, because of the distribution system, an on-line vendor, large or small, makes Internet access available to the entire world. The licensor's location does not depend on the location of the computer that contains the information. Any other choice of law rule would require that the information provider (small or large) comply with the law of all states and all countries since it may not be clear or even knowable where the contract is formed or the information sent.

Subsection (b)(2) is a consumer protection rule that applies to transactions involving delivery of tangible (physical) copies. In the absence of agreed terms, the law of the place where the copy was to be delivered governs. Thus, if a consumer is to receive delivery of a physical copy of software in Chicago, the transaction is subject to the law of Illinois unless the agreement indicates otherwise. This rule is consistent with current U.S. law and is followed in many European countries. It adopts, for the consumer, the location that is most likely to be consistent with its expectations in the transaction and avoids surprise to the provider because the copy provided is, by definition, to be delivered into that state.

The rules in subsection (b), of course, deal only with contract law. They do not affect choice of law in tax, copyright, or other fields of law. See *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992) (tax nexus); *Allarcom Pay Television, Ltd. v. General Instrument Corp.*, 69 F.3d 381 (9th Cir. 1995) (copyright).

4. *Most Significant Relationship.* In the absence of an agreement and except for the rules in subsections (b)(1) and (b)(2), subsection (b) adopts a "most significant relationship" test. The *Restatement (Second) of Conflicts of Law* uses a similar test and cases interpreting that rule are applicable here. The "most significant relationship" standard requires consideration of various factors including the: (a) place of contracting, (b) place of negotiation, (c) place of performance, (d) location of the subject matter of the contract, (e) domicile, residence, nationality, place of incorporation and place of business of the parties, (f) needs of the interstate and international systems, (g) relative interests of the forum and other interested states in the determination of the particular issue, (h) protection of justified expectations of the parties, and (i) promoting certainty, predictability and uniformity of result.

5. *Foreign Countries.* Subsection (c) does not apply if an enforceable contract term designates what law applies. Subsection (c) provides a rule for cases where the default rules in subsection (b) result in selecting the law of a foreign country and the law of that country is substantively inappropriate because it fails to give a party substantially similar protections to those available under this Act. As under subsection (b), the reference is solely to contract law, including the provisions of this Act and the general contract and related equity law of the jurisdiction. The general principle in (c) is especially important in Internet commerce. The rule allows a court to use a different choice of law principle. In applying subsection (c), courts should alter the basic rule only in extreme cases. It does not suffice merely that the foreign law is different. The differences must be substantial and adverse.

1-110. CONTRACTUAL CHOICE OF FORUM.

Definitional Cross References. Section 102: "Agreement"; "Party"; "Term".

Official Comments:

1. *Scope of the Section.* This section deals with contractual choice of an exclusive judicial forum. It deals only with choice of a judicial forum. Arbitration and other non-judicial forum choices are governed by other law.

2. *General Rule.* Choice of forum agreements are generally enforceable. This section adopts the approach of cases following *Bremen v. Zapata Offshore Co.,* 407 U.S. 1 (1972), which treat choice of forum clauses as presumptively valid. The *Restatement (Second) of Conflicts of Law* follows a similar rule.

3. *Limitation.* As with any other term of an agreement, terms which select an exclusive forum are subject to the doctrine of unconscionability in Section 111 and the fundamental public policy standard described in Section 105. In addition, a choice of an exclusive forum is not enforceable if it is unreasonable and unjust. This rule follows the approach established under *Breman* and its progeny and corresponds to the limitation suggested in the *Restatement.* The term is unenforceable if it has no valid commercial purpose and has severe and unfair affects on the other party. This precludes enforcement of forum selection clauses that choose a forum solely to defeat the other party's ability to contest disputes. Such terms may be unreasonable in that they have no commercial purpose or justification and their impact may be unjust in that the term unfairly harms the other party. On the other hand, a contractual choice of forum based on a valid commercial purpose is not invalid simply because it adversely effects one party, even in cases where bargaining power is unequal. The burden of establishing that the clause fails lies with the party asserting its invalidity. *Bremen v. Zapata Offshore Co.,* 407 U.S. 1 (1972);*Pelleport Investors, Inc. v. Budco Quality Theaters, Inc.,* 741 F.2d 273 (9th Cir. 1984); *Restatement (Second) of Conflicts of Law* § 80, comment c (1989 rev.).

Choice of forum terms are especially important in electronic commerce. Decisions on the issue of jurisdiction in the Internet reveal an uncertainty about when doing business on the Internet exposes a party to jurisdiction in all states and all countries. The uncertainty affects both large and small enterprises, but has greater impact on small enterprises which are the lifeblood of electronic Internet commerce. Choice of forum terms here serve a significant commercial by allowing parties to control the uncertainty and the risk or costs it creates. Courts have recognized the importance of the issue. See, e.g., *Evolution Online Systems, Inc. v. Koninklijke Nederlan N.V.*, 145 F.3d 505 (2nd Cir. 1998); *Caspi v. The Microsoft Network, L.L.C. et. al*., -- N.E.2d -- (N.J. Super. Ct. 1999). The Court's discussion in *Carnival Cruise Lines, Inc. v. Shute*, 111 S.Ct. 1522 (1991) on choice of forum in a different, but similarly international context is relevant to determining reasonableness in Internet contracting:

> [It would] be entirely unreasonable to assume that a cruise passenger would or could negotiate the terms of a forum clause in a routine commercial cruise ticket form. Nevertheless, including a reasonable forum clause in such a form well may be permissible for several reasons. Because it is not unlikely that a mishap in a cruise could subject a cruise line to litigation in several different fora, the line has a special interest in limiting such fora. Moreover, a clause establishing [the forum] has the salutary effect of dispelling

> confusion as to where suits may be brought…. Furthermore, it is likely that passengers purchasing tickets containing a forum clause … benefit in the form of reduced fares reflecting the savings that the cruise line enjoys….

In electronic commerce, contractual choice of forum will often be justified on the basis of the risk and uncertainty that would otherwise exist. Choice of a forum at a party's location is ordinarily reasonable.

4. *Non-exclusive Forum.* Subsection (b) adopts the traditional contract interpretation rule that a choice of judicial forum term in an agreement makes a non-exclusive choice unless the agreement expressly provides otherwise. Requiring express exclusivity terms provides notice and reflects what, in most cases, is the expectations of the parties in the absence of such language. The enforceability of non-exclusive forum selection clauses is not addressed in this Act. Presumably, absent unconscionability or other over-riding restriction, these clauses present less reason for intruding on contract choices than do the clauses dealt with in this section.

1-111. UNCONSCIONABLE CONTRACT OR TERM.

Uniform Law Source: Uniform Commercial Code § 2-302 (1998 Official Text).

Definitional Cross References: Section 102: "Contract"; "Court"; "Term".

Official Comments:

1. *Scope of the Section.* This section adopts unconscionability doctrine as applied in Uniform Commercial Code 2-302 (1998 Official Text).

2. *Basic Policy and Effect.* This section and Section 114 allows courts to rule directly on the unconscionability of the contract or a particular term. The basic test is whether, in light of the general commercial background and the commercial needs of the particular trade or case, the terms involved are so one-sided as to be unconscionable under the circumstances existing at the time of the making the contract. The principle is one of the prevention of oppression and unfair surprise and not of disturbance of allocation of risks because of superior bargaining power. Since its adoption in Article 2 of the U.C.C., the doctrine of unconscionability has received continuing attention from the courts and remains a useful tool that enables courts to police explicitly against the contracts or clauses which they find to be unconscionable. See e.g., *Brower v. Gateway 2000, Inc.,* 676 NYS.2d 569 (N.Y.A.D. 1998).

3. *Electronic commerce.* This Act confirms the enforceability of automated contracting involving "electronic agents," but in some cases automation may produce unexpected and potentially oppressive results due to errors in programs, problems in communication, or other unforeseen circumstances in the automation process. Common law concepts of mistake may apply, as may Sections 206 and 214. In addition, in appropriate cases, unconscionability doctrine may invalidate a term of the contract because of a procedural breakdown in the automated contracting process that produces unexpected and oppressive results in the terms of the agreement.

4. *Remedy.* The court, in its discretion, may refuse to enforce the contract as a whole if it is permeated by the unconscionability, or it may strike any single term or group of terms which are so tainted or which are contrary to the essential purpose of the agreement, or it may simply limit unconscionable clauses so as to avoid unconscionable results.

5. *Decision of the court.* Unconscionability is a decision to be made by the court. The commercial evidence allowed under subsection (b) is for the court's consideration, not for the jury. Only the terms of the agreement which result from the court's action on these matters are to be submitted to the general triers of fact for resolution of a matter in dispute.

1-112. MANIFESTING ASSENT; OPPORTUNITY TO REVIEW.

Uniform Law Source: Restatement (Second) of Contracts § 19.

Definitional Cross References. Section 102: "Agreement"; "Authenticate"; "Copy"; "Electronic"; "Electronic agent"; "Delivery"; "Information"; "Informational Rights"; "Knowledge"; "Mass-market license"; "Person"; "Record"; "Return"; "Term". Section 114: "Reason to know".

Official Comments:

1. *Scope of Section.* This section provides standards for "manifestation of assent" and "opportunity to review," important concepts for making contracts in electronic commerce. In this Act, "opportunity to review" a record is a precondition to manifesting assent to it. "Manifesting assent" as a concept has several roles in common law and this Act. It is: 1) one method by which a party agrees to (accepts) a contract; 2) a method by which a party may adopt terms of a record as the terms of a contract; and 3) if required by this Act, a means of assenting to a particular term. In most cases, the same acts accomplish both the first and second result.

2. *General Theme.* The term, "manifesting assent," comes from *Restatement (Second) of Contracts* § 19. This section corresponds substantively to *Restatement § 19* but more fully explicates the concept. Codification in this Act creates uniformity in terminology and application that is lacking in common law.

The basic principle is that words are not the only means of indicating assent to a contract or its terms and that conduct can often convey assent as, or more clearly as, can words. This is an important principle in electronic contracting where most interactions involve conduct, rather than spoken words. The *Restatement* states: "The manifestation of assent may be made wholly or partly by written or spoken words or by other acts or by failure to act." *Restatement (Second) of Contracts* § 19(1). Subsection (a) adopts this view. Subsection (b) adapts the principle to use of electronic agents. Manifesting assent does not require any specific formality of language or conduct.

In this Act, determining whether a person manifested assent to a record or term requires analysis of three issues:

- First, the person must have knowledge of the record or term or an opportunity to review it before assenting. As described in subsection (e), opportunity to review requires that the record be made available in a manner that ought to call it to the attention of a reasonable person and in a form that readily permits review. Subsection (e) also requires a right of return if the record is not presented before initial performance.
- Second, given an opportunity to review, the person must do something that assents to the terms. The person may authenticate the record or term, express assent verbally, or intentionally engage in conduct with reason to know that in the circumstances the conduct indicates assent. *Restatement (Second) of Contracts* § 19. Conduct manifests assent only if the party's behavior was intentional and with knowledge or reason to know that the other party would infer assent from it. As in the *Restatement* the conduct can include inaction if the circumstances so indicate.
- Third, the conduct, statement, or authentication must be attributable to the person. General agency law and Section 213 provide standards for attribution.

3. *Manifesting Assent.*

*a***.** *Assent by Statements or Authentication.* As under common law, a person can assent to a record or term by stating its consent or by "authenticating" the record or term. Authentication either is a "signature" or an electronic equivalent. The term "authenticate" is adopted to enable electronic commerce, but the underlying concepts relating to signature remain the same. See Section 102 (definition of authentication).

*b***.** *Assent by Conduct.* Assent occurs if a person acts (or fails to act) having reason to know its behavior will be viewed by the other party as indicating assent. Whether this occurs depends on the circumstances. As in common law, assent does not require proof of a person's subjective intent or purpose, but focuses on objective factors, including whether there was an act or a failure to act voluntarily engaged in with reason to know that the inference of assent would be drawn.

Actions objectively indicating assent are effective even though the actor may subjectively intend otherwise. This follows traditional contract law of "objective" assent. It is especially important in electronic commerce where many transactions do not involve contact between individuals. Parties on both sides must rely on objective acts indicating acceptance. Doctrines of mistake as well as the law relating to fraud and duress apply in appropriate cases.

Assent in common law and in this Act does not require that a party be able to negotiate or modify terms. But the assenting behavior must be intentional (voluntary). This is satisfied if the alternative of refusing the deal or terms exists even if refusing terms leaves no alternative source for the subject matter of the contract. It is not satisfied if the act treated as assent is one which the assenting party cannot reasonably avoid doing even if it refuses the contract, such as blinking one's eyes.

Under this same general standard, common law courts have used common sense in applying this test and will do so under this Act. Similarly, an act that does not bear a relationship to a contract or a record might fail under the general standard. Acts that occur in context of a mutual express reservation of the right to defer agreement do not manifest assent to a contract that neither party intended; neither party has any reason to believe that its conduct will suggest assent to the other party.

Actual knowledge that particular conduct will be viewed as assent suffices. Also, actions are treated as assent if a person has "reason to know" that they will lead the other party to the inference that there was assent. Factors that relate to this issue include: the ordinary expectations of similar persons in similar contexts; language on a display, package, or otherwise that is made available to the party before it acts; the fact that the party can decline and return the information without using it,

but decides to use the information; information about contract terms communicated to the actor before conduct occurred; standards and practices of the business, trade or industry of which the person has reason to know; and other relevant factors.

The reason to know standard is not met where computer information is sent to a recipient unsolicited under terms that purport to create a binding contract by failure to object to the unsolicited sending. In such cases, it is not reasonable for the sending party to infer assent from silence and, therefore, the threshold for manifesting assent is not met.

c. *Assent by Electronic Agents.* Assent may occur through automated systems, described in this Act as "electronic agents." Either or both parties (including consumers) may use electronic agents. The reduced transaction costs from the technology are immense for consumers and for providers of information. However, when dealing with electronic agent assent, that assent cannot be based on knowledge or reason to know of the principal since programs are capable of neither and since the remote.

Automated nature of the interaction may preclude either individual party from any awareness (this does not, however, preclude persons who program agents from having reason to know of usage of trade and the like or preclude that knowledge from being programmed into the agent – the issues is not relevant under subsection (b) because the subsection focuses on the acts, not the knowledge, of the agent). Subsection (b) focuses on whether there was an authentication or whether in the overall circumstances, the electronic operations indicate assent.

For both electronic agents and individuals, manifesting assent requires a prior opportunity to review. Subsection (e)(2) buttresses this automated assent by providing that, for an electronic agent, the opportunity has been made available only if the record or term is presented in such a way that a reasonably configured electronic agent could react to it. The capability of an automated system to react and an assessment of the implications of its actions are more appropriate measures of assent than concepts of knowledge or reason to know.

d. *Assent to particular terms.* This Act distinguishes assent to a record and, when required by this Act or other law, assent to a particular term within the record. Assent to a record relates to the record as a whole and generally encompasses all terms of the record. Section 208. Assent to a particular term, if required, requires acts that specifically relate to that particular term. This is like a requirement that a party "initial" an individual clause of a record to make it effective. One act, however, may assent to both the record and the term if the circumstances, including the language of the record, clearly indicate to the party that doing the act is also assent to the particular term.

4. *Assent and Terms of an Agreement.* Manifestation of assent to a record containing contract terms is not the only way in which parties establish their bargain. This Act does not alter recognition of those other methods of agreeing to terms. For example, a product description can become part of an agreement without a manifestation of assent to a record repeating that description; in appropriate cases, the product description defines the bargain itself.

This is implicit in the basic principle that this Act, like Article 2 of the U.C.C., defines the agreement based on the commercial circumstances. A party that markets a database of names of consumer attorneys can rely on the fact that the product need only contain consumer attorneys because this is the basic bargain it proposes; the provider is not required to seek manifest assent to a record stating that part of the deal. Similarly, the licensee can rely on the fact that the database must contain consumer attorneys, not other lawyers.

The described nature of the product defines the bargain if the party makes the acquisition on that basis. If a product is clearly identified on the package or in representations to the licensee as being for consumer use only, the terms are effective without requiring language in a record restating the description or conduct assenting to that record. Of course, if the nature of the product is not obvious and there is no assent to a contract defining that nature or other agreement to it, such conditions might not become part of the agreement.

In many cases, copyright or other intellectual property notices restrict use of a product, regardless of assent to contract terms. For example, common practice in video rentals places a notice on screen of limits on the customer's use under applicable copyright and criminal law, such as by precluding commercial public performances. The enforceability of such notices typically does not depend on compliance with procedures of assent.

5. *Proof of Assent.* A wide range of behavior and interactions in commerce establish consent to a contract or particular terms. It is not possible to state the variety of options that might manifest assent. In the anonymous world of electronic commerce, however, one of the most important is by showing that a process existed that required an authentication or other assent in order to proceed in an automated system. This is recognized in subsection (d). Of course, the procedure not only must exist, but be in place in a manner that the person must have engaged in it.

Subsection (d) also contains language to encourage use of duplicative consent procedures when appropriate. It makes clear that if the assenting party has an opportunity to confirm or deny assent before proceeding to obtain or use information, confirmation meets the requirement of subsection (a)(2). This alternative does not impair the effectiveness of a single indication of assent, by an electronic or other act; it simply provides a safe harbor for those obtaining electronic assent and a opportunity to confirm or deny assent for those who provide assent.

Illustration 1: The registration screen for NY Online prominently states: "Please read the License. It contains important terms about your use and our obligations with respect to the information. If you agree to the license it, indicate this by clicking the "I agree" button. If you do not agree, click "I decline". The on-screen buttons are clearly identified. The underlined text is a hypertext link which, if selected, promptly displays the license. A party that indicates "I agree" manifests assent to the license and adopts its terms.

Illustration 2: The first display screen of an on-line stock-quote service requires that the potential licensee enter their name, address and credit card number. After entering the information and striking the "enter" key, the licensee has access to the data and receives a monthly bill. Somewhere below the above hidden in other small print, is the statement: "Terms and conditions of service; disclaimers" indicating a hyperlink to the terms.

The customer's attention is not called to this sentence, nor is the customer asked to react to it. Even though entering name and identification, coupled with using the service, assents to a contract, there is no assent to the "terms of service" and disclaimer since there is no act indicating assent to the record containing the terms. A court would determine the contract terms on other grounds, including the default rules of this Act and usage of trade.

Illustration 3: The purchase order screen of an on-line software provider's service provides the terms of the license, a space to indicate the software purchased, and two on-screen buttons indicating "I agree" and "I decline" respectively. A user that completes the order and indicates "I agree", causes the system to move to a second screen. This second screen summarizes the order and asks the user to click confirming its order, or canceling it. Under this subsection (d), this double assent sequence satisfies subsection (a)(2) regarding the intentional conduct and reason to know standard. It also satisfies the error correction procedure in Section 214.

6. *Authority to Act.* The person manifesting assent must be one that can bind the party seeking the benefits or being charged with the obligations or restrictions of the agreement. In general, this Act treats this issue as a question of attribution: are the assent-producing acts attributable to this particular person? A person that desires to enforce terms against another must establish that it dealt with an individual that had authority to bind the person or, at least, establish that the person accepted the benefits of the contract or otherwise ratified the acts. If the individual who assented did not have authority and the conduct was not ratified or otherwise adopted, there may be no assent as to the party "represented," but only as to the individual who acted.

If this occurs, both the purported principal and the relying party may be exposed to loss: the relying party (e.g., licensor) risks loss of its terms, while the purported principal ("licensee" using information not obtained through a proper agent) risks that use of the information infringes a copyright or patent. There must be an adequate connection between the individual who had the opportunity to review and who manifested assent and the person one whose acts constitute assent. Of course, a party with authority can delegate that authority to another. Thus, a CEO may implicitly authorize her secretary to agree to a license when the CEO instructs the secretary to sign up for legal materials online or to install a newly acquired program that is subject to a screen license.

Questions of this sort arise under agency law as augmented in this Act. In appropriate cases, rules in this Act on attribution play a role in resolving whether the ultimate party is bound to the contract terms. Section 213 deals with when, in an electronic environment, a party is bound to records purporting to have come from that party. Other law governs questions of ordinary agency.

7. *Third Party Service Providers.* Assent requires conduct by the party to be bound or its agents. In many Internet situations, a party is able to reach a particular system because of services provided by a third party communications or other service provider. In such cases, the services provider typically does not intend to engage in a contractual relationship with the provider of the information. While the "customer" activity may constitute assent to terms, it does not bind the service provider since the service provider's actions are in the nature of transmissions and making information access available, not assent to a contractual relationship.

This Act is clear that service providers – providers of online services, network access, or the operation of facilities thereof – do not manifest assent to a contractual relationship simply from their provision of such services, including but not limited to transmission, routing, providing connections, linking or storage of material at the request or initiation of a person other than the service provider. If,

for example, a telecommunications company provided the routing for a user to reach a particular online location, the fact that the user of the service might assent to a contract at that location does not mean that the service provider has done so. The conduct of the customer does not bind the service provider.

Of course, in some on-line systems the service provider has direct contractual relationships with the content providers or may desire access to and use the information on its own behalf, and therefore may assent to terms in order to obtain access. In the absence of these circumstances, however, the mere fact that the third-party service provider enables the customer to reach the information site does not constitute assent to the terms at that site.

8. *Opportunity to Review.* A manifestation of assent under this Act cannot occur unless there was an opportunity to review the record or term to which the assent is directed. Common law is not clear on this requirement, but it reflects simple fairness and codifies or adapts concepts preventing procedural unconscionability. For a "person," an opportunity to review requires that a record be made available in a manner that ought to call it to the attention of a reasonable person and permit review. This requirement, of course, is clearly met if the person actually knows the terms of the record or has reason to know that the record or term exists in a form and location that in the circumstances permits review of it or a copy of it. For an electronic agent, an opportunity to review exists only if the record is one to which a reasonably configured electronic agent could respond.

a*. Declining to Use the Opportunity to Review.* An opportunity to review does not require that the person use that opportunity; the condition is met even if the person foregoes the opportunity. Contract terms offered for review during an over-the-counter transaction or made available in a binder as may be required under federal law give an opportunity to review even if the person does not use that opportunity. This is not changed because the party desires to complete the transaction rapidly, is under pressure to do so, or because the party has other demands on its attention, unless the one party intentionally manipulates the circumstances to induce the other party not to review the record.

b*. Permits Review.* How a record is made available for review differs for electronic and paper records. In both, however, a record is not available for review if access to it is so time-consuming or cumbersome as to effectively preclude review. It must be presented in a way as to reasonably permit review. In an electronic system, a record promptly accessible through an electronic link ordinarily qualifies. Actions that comply with federal or other applicable consumer laws that require making contract terms or disclosure available, or that provide standards for doing so, satisfy this requirement.

c**.** *Right to Return.* In commerce, there are many circumstances when terms in a record are not available until after there is a commitment to the transaction. As indicated in subsection (e), in most such cases there is no opportunity to review unless the party can return the product (or in the case of a vendor that refuses the other party's terms, recover the product) and receive reimbursement of any payments if it rejects the contract terms contained in the record. This rule does not exist in prior law but creates important protection for the party asked to assent. When the right to return is established by agreement, rather than by operation of law, it must be part of the express terms such that the person can become aware of it.

This rule provides strong incentive for a licensor to make the terms of the license available up-front if commercially practicable. Doing so avoids the obligations regarding a right of return stated in this section and in Sections 209 and 613. In addition, under Sections 208 and 209, when presentation of initial terms is deferred in this manner, the terms cannot become part of the contract unless the other party had reason to know that some terms would be later presented. Thus, a decision to defer presentation of terms without an important commercial reason to do so, may result in substantial costs and uncertainty. The required return right exists only for the first licensee.

Failure to provide a right to return in cases of records presented after the initial commitment to the transaction does not invalidate the agreement, but creates the risk that the terms will not be assented to by the party to which they were presented. The enforceable terms of the agreement must be determined by consideration of all the circumstances, including the expectations of the parties, applicable usage of trade and course of dealing, and the property rights, if any, involved in the transaction. Section 210. In such cases, courts should be careful to avoid unwarranted forfeiture or unjust enrichment regarding the conditions or terms of the agreement. An agreement whose payment and other agreed terms reflect a right to use for consumer purposes only cannot be transformed into an unlimited right of commercial use by a failure of assent.

9. *Modifications and Layered Contracting.* The return provisions do not apply to or alter law on modification of an agreement or the law regarding the agreed right of a party to specify particulars of performance. Similarly, as outlined in subsection (e), the return right does not apply in commercial contexts where parties begin performance in the expectation that a record containing contract terms

will be presented and adopted later. This is a common occurrence in development and other complex contracts and this Act does not disturb that commercial practice.

10. *Modification of Rules.* Section 113(a) precludes alteration of some portions of Section 211 by agreement. Subsection (f), however, allows parties, by a prior agreement, to restructure what does and does not constitute assent with respect to future conduct; this restructuring may call for more or fewer protections than are found in Section 211 or this Act. This is important for the many cases in which electronic commerce occurs through repeated exchanges pursuant to prior agreements. The requirements of assent in such cases can just as well be found in the original agreement as in subsequent conduct. In most cases, the prior agreement would satisfy the requirements of this section in full even as to the subsequent transactions.

1-113. Variation by Agreement; Commercial Practice.

Uniform Law Source: Uniform Commercial Code §§ 1-102(3); 1-203; 1-205(3); 2-303.

Definitional Cross References: Section 102: "Agreement"; "Contract"; "Conspicuous"; "Financier"; "Party"; "Return"; "Term". Section 112: "Manifesting assent"; "Opportunity to Review."

Official Comments:

1. *Scope of Section.* This section sets out basic principles that relate to determining the effect and meaning of an agreement. They generally follow the Uniform Commercial Code (1998 Official Text).

2. *Contract Choice.* Subsection (a) states affirmatively at the outset that freedom of contract is a fundamental principle of this Act. See Uniform Commercial Code § 1-102(3), *Official Comment* 2 (1998 Official Text). With narrow exceptions, the agreement of the parties will be honored. The effect of all provisions of this Act may be varied by agreement unless otherwise expressly stated as being non-variable.

The absence of the phrase "unless otherwise agreed" or similar language does not have any negative inference or change this principle. An "agreement" does not require a formal record, but refers to the bargain of the parties in fact. Of course, to be enforceable under Section 201, a record may be required. The agreement is determined giving full appropriate effect to usage of trade, course of dealing and course of performance. An agreement altering the effect of any section of this Act may be as easily found in express terms as in course of dealing, course of performance, or usage of trade.

An agreement to vary the effect of a provision of this Act must be between the parties to which the provision applies. Several provisions allow a financier to establish financing with a licensee subject to restrictions that protect rights of the licensor. An agreement between the licensee and financier cannot alter the provisions insofar as they pertain to protecting the licensor and its rights. Such an agreement would not be between the affected parties. On the other hand, an agreement between the financier and the licensor may alter the effect of those provisions as between those parties, but cannot alter rights of the licensee.

Subsection (a) lists cases in which a provision of this Act overrides agreement. In each case, a policy judgment was made that the Act provision reflects policies that should not be altered except as indicated in those sections or here. Paragraph (a)(1) follows U.C.C. § 1-102(3) (1998 Official Text) in precluding complete waivers of good faith and other stated requirements, but in allowing parties by agreement to establish standards under which performance of the obligation is measured. Paragraph (a)(2) likewise recognizes the policy basis of unconscionability doctrine and the doctrine described in Section 105(b). In both cases the idea of setting standards is not applicable because the doctrine itself limits the ability to make contract choices.

Exceptions to contract choice should be sparingly applied. For example, subparagraph (c)(3)(C) prohibits variation of certain aspects of manifest assent and opportunity to review. Obviously, that prohibition is designed as a protection to persons who manifest assent. However, parties are free to agree for *greater* protections when they so desire and, in appropriate cases, to provide lesser assent standards under an agreement with respect to future transactions as indicated in the section on manifesting assent. Section 112(f).

3. *Usage of Trade, etc.* This Act follows basic principles of contract law established in the Uniform Commercial Code 1998 Official Text) and generally throughout U.S. contract law. The first is that the terms of an *agreement* must be found by looking to the commercial context in which the transaction occurs. Subsection (b) states this principle and derives from U.C.C. § 1-205 (1998 Official Text). Agreements can include and must be considered in light of the commercial context, which includes usage of trade, course of dealing, and course of performance; these furnish the background and give particular meaning to language used.

They set a framework of common commercial understanding that controls rules of law which apply only if there is no such understanding. . Similarly, the meaning of the terms of any agreement must be

viewed in light of practical considerations. Abstract concepts about what an agreement should mean are not as important as are grounded interpretations of what an agreement does mean in practical context. See Section 302 (relationship between express terms and among the sources of commercial interpretation).

4. *Gap-filler Rules.* With the exceptions stated here, all rules in this Act are "default" or "gap-filler" rules which apply only in the absence of contrary agreement or meanings supplied by trade usage, or course of performance or dealing. Freedom of contract is especially important for converging industries or richly diverse commercial practice. Agreed terms that alter default rules do not require specific reference to the default rule and ordinarily do not require use of specific language, presentation or assent, unless expressly so required by this Act. In some situations, for example, this Act expressly imposes a requirement such as that a term be conspicuousness or that there be manifested assent to the term. Such requirements exist only if made express in this Act or if they are created in consumer protection statutes or regulations as described in Section 105.

1-114. SUPPLEMENTAL Principles; GOOD FAITH; DECISION FOR COURT; REASONABLE TIME.

U**niform Law Source**: Uniform Commercial Code §§ 1-102(3); 1-104; 1-203; 1-205(3); 2-303.

Definitional Cross References: Section 102: "Agreement"; "Contract"; "Conspicuous"; "Consumer"; "Court"; "Financier"; "Good faith"; "Knowledge".

Official Comments:

1. *Scope of Section.* This section sets out basic principles of contract law followed in this Act. They generally follow the Uniform Commercial Code (1998 Official Text).

2. *Supplemental Rules.* Subsection (a) derives, with modifications, from Uniform Commercial Code § 1-103 (1998 Official Text). There are many common law contract rules with which this Act does not deal and which remain in place to supplement this Act unless displaced by the Act. Ordinarily, the appropriate supplementation comes from general common law, rather than from contract statutes addressing subject matter different from that covered in this Act. Supplementation does not imply that a common law rule can over-ride express rules or clear policies adopted in this Act, such as a policy that requires or does not require, a particular formality for a particular contractual result. The displacing effect of this Act with respect to common law is found not only in particular provisions of the Act, but also more generally in the policies adopted in the Act.

The listing given in this section is merely illustrative; no listing could be exhaustive. Nor is the fact that in some sections particular circumstances have led to express reference to other fields of law intended to at any time to suggest the negation of the general application of the principle of this subsection. There are a range of broadly applicable competition, tax, regulatory, and property laws with which this Act does not deal since it is concerned with contract law. As made clear in subsection (a), trade secret law and unfair competition law are not displaced by this Act, but supplement it pursuant to the first sentence of the subsection. Thus, if trade secret or competition law renders a particular type of contract term invalid under that law, this Act does not alter that result. A similar proposition is outlined for consumer protection statutes in Section 105, which govern in the case of any conflict with this Act.

This Act does not deal with computer viruses and does not alter existing criminal, tort, or other law on that subject. In most jurisdictions, knowing or intentional introduction of a computer virus is a criminal act. See Raymond Nimmer, *Information Law* ¶ 9.04 (1997). Any remedy in contract is determined by the rules of this Act or by the agreement. Absent agreement, no basis for allocating risk under contract principles exists and this Act leaves the issue to other law.

2. *Good Faith.* Subsection (b) follows Uniform Commercial Code 1-203 (1998 Official Text), but this Act adopts a definition of "good faith" that is consistent with U.C.C. 2-103 (1998 Official Text). This subsection adopts the rule that good faith is a relevant to the performance due under all contract relationships within its scope, thus expanding the idea of good faith in states that have not adopted this view in their common law.

What is meant by good faith is defined in Section 102. While good faith in performance is an element of all contracts covered by this Act, the obligation of good faith does not over-ride express contract terms or the right to enforce them. *See Kham & Nates Shoes No. 2, Inc. v. First Bank of Whiting,* 908 F.2d 1351 (7th Cir. 1990); *Amoco Oil Co. v. Ervin,* 908 P.2d 493 (Colo. 1995); *Badgett v. Security State Bank*, 116 Wn.2d 563, 807 P.2d 356 (1991). A lack of good faith is not shown simply by the fact that the party insisted on compliance with terms. The fair dealing concept does not alter the rule that good faith obligations do not over-ride, or create new contractual obligations. *Ohio Casualty Company v. Bank One,* 1997 WL 428515 (N.D. Ill. 1997).

This section does not support an independent cause of action for failure to perform or enforce in good faith. Rather, a failure to perform or enforce in good faith a specific duty or obligation under the

contract is a breach of that contract. This distinction makes it clear that the doctrine of good faith merely directs a court towards interpreting contracts within the commercial context in which they are created, performed, and enforced, and does not create a separate duty of fairness and reasonableness which can be independently breached. See PEB Commentary No.10.

3. *Issues as a Matter for the Court.* As to unconscionability and conspicuousness, subsection (c) follows Uniform Commercial Code §§ 1-201(10); 2-302 (1998 Official Text) and common law on what issues are reserved for decision by a court. In addition, federal preemption and fundamental public policy are questions for the court. Other issues are also made questions for the court. These are indicated in this section, the relevant substantive section, or in applicable case law or procedural rules.

4. *Legal Effect.* Subsection (d) derives from Uniform Commercial Code Article 1, moving this legal principle from the definition of "agreement" to a separate substantive section, but without substantive change in law.

5. *Reasonable Time.* Subsection (e) derives from Uniform Commercial Code § 1-204 (1998 Official Text). Reasonable time, when used in this Act, is gauged by the commercial context. In this regard, nothing is stronger evidence of a reasonable time than the fixing of such time by an agreement between the parties. However, the subsection makes provision for disregarding a contractual term which by inadvertence or over-reaching fixes a time so unreasonable that it amounts to eliminating all remedy under the contract. The parties are not required to fix the most reasonable time but may fix any time which is not obviously unfair as judged at the time of contracting. The agreement which fixes the time need not be part of the main agreement, but may be separate. Under the definition of "agreement", the circumstances of the transaction, including course of dealing, course of performance, or usage of trade may be material.

6. *Reason to know.* This concept is consistent with *Restatement (2d) Contracts* § 19, *Comment* b. A person has reason to know a fact if the person has information from which a reasonable person would infer that the fact does or will exist based on all the circumstances, including the overall context and ordinary expectations. The person is charged with commercial knowledge of any factors in a particular transaction which in common understanding or ordinary practice are to be expected, including reasonable expectations from usage of trade and course of dealing. If a person has specialized knowledge or superior intelligence, reason to know is determined in light of whether a reasonable person with that knowledge or intelligence would draw the inference that the fact does or will exist. There is also reason to know if, from all the circumstances, the inference would be that there is such a substantial chance that the fact does or will exist that, exercising reasonable caution regarding the matter in question, the person would predicate its actions on the assumption of its existence.

"Reason to know" must be distinguished from knowledge. Knowledge means an actual conscious belief in or awareness of a fact. Reason to know need not entail a conscious belief in the existence of the fact or its probable existence in the future. Of course, a person that has knowledge of a fact also has reason to know of its existence. Reason to know is also to be distinguished from "should know." "Should know" imports a duty to ascertain facts; the term "reason to know" does not entail or assume an obligation to investigate, but is determined solely by the information available to the party. The term is used where the person would not be acting adequately in protecting its own interests if it did not act in light of the facts of which it had reason to know.

PART 2. GENERAL DEFINITIONS AND PRINCIPLES OF INTERPRETATION

1-201. General Definitions.

(a) Unless the context otherwise requires, words or phrases defined in this section, or in the additional definitions contained in other articles of [the Uniform Commercial Code] that apply to particular articles or parts thereof, have the meanings stated.

(b) Subject to definitions contained in other articles of [the Uniform Commercial Code] that apply to particular articles or parts thereof:

(1) "**Action**", in the sense of a judicial proceeding, includes recoupment, counterclaim, set-off, suit in equity, and any other proceeding in which rights are determined.

(2) "**Aggrieved party**" means a party entitled to pursue a remedy.

(3) "**Agreement**", as distinguished from "contract", means the bargain of the parties in fact, as found in their language or inferred from other circumstances, including course of performance, course of dealing, or usage of trade as provided in Section 1-303.

(4) "**Bank**" means a person engaged in the business of banking and includes a savings bank, savings and loan association, credit union, and trust company.

(5) "**Bearer**" means a person in possession of a negotiable instrument, document of title, or certificated security that is payable to bearer or indorsed in blank.

(6) "**Bill of lading**" means a document evidencing the receipt of goods for shipment issued by a person engaged in the business of transporting or forwarding goods.

(7) "**Branch**" includes a separately incorporated foreign branch of a bank.

(8) "**Burden of establishing**" a fact means the burden of persuading the trier of fact that the existence of the fact is more probable than its nonexistence.

(9) "**Buyer in ordinary course of business**" means a person that buys goods in good faith, without knowledge that the sale violates the rights of another person in the goods, and in the ordinary course from a person, other than a pawnbroker, in the business of selling goods of that kind. A person buys goods in the ordinary course if the sale to the person comports with the usual or customary practices in the kind of business in which the seller is engaged or with the seller's own usual or customary practices.

A person that sells oil, gas, or other minerals at the wellhead or minehead is a person in the business of selling goods of that kind. A buyer in ordinary course of business may buy for cash, by exchange of other property, or on secured or unsecured credit, and may acquire goods or documents of title under a preexisting contract for sale. Only a buyer that takes possession of the goods or has a right to recover the goods from the seller under Article 2 may be a buyer in ordinary course of business. "Buyer in ordinary course of business" does not include a person that acquires goods in a transfer in bulk or as security for or in total or partial satisfaction of a money debt.

(10) "**Conspicuous**", with reference to a term, means so written, displayed, or presented that a reasonable person against which it is to operate ought to have noticed it. Whether a term is "conspicuous" or not is a decision for the court. Conspicuous terms include the following: (A) a heading in capitals equal to or greater in size than the surrounding text, or in contrasting type, font, or color to the surrounding text of the same or lesser size; and (B) language in the body of a record or display in larger type than the surrounding text, or in contrasting type, font, or color to the surrounding text of the same size, or set off from surrounding text of the same size by symbols or other marks that call attention to the language.

(11) "**Consumer**" means an individual who enters into a transaction primarily for personal, family, or household purposes.

(12) "**Contract**", as distinguished from "agreement", means the total legal obligation that results from the parties' agreement as determined by [the Uniform Commercial Code] as supplemented by any other applicable laws.

(13) "**Creditor**" includes a general creditor, a secured creditor, a lien creditor, and any representative of creditors, including an assignee for the benefit of creditors, a trustee in bankruptcy, a receiver in equity, and an executor or administrator of an insolvent debtor's or assignor's estate.

(14) "**Defendant**" includes a person in the position of defendant in a counterclaim, cross-claim, or third-party claim.

(15) "**Delivery**", with respect to an instrument, document of title, or chattel paper, means voluntary transfer of possession.

(16) "**Document of title**" includes bill of lading, dock warrant, dock receipt, warehouse receipt or order for the delivery of goods, and also any other document which in the regular course of business or financing is treated as adequately evidencing that the person in possession of it is entitled to receive, hold, and dispose of the document and the goods it covers. To be a document of title, a document must purport to be issued by or addressed to a bailee and purport to cover goods in the bailee's possession which are either identified or are fungible portions of an identified mass.

(17) "**Fault**" means a default, breach, or wrongful act or omission.

(18) "**Fungible goods**" means: (A) goods of which any unit, by nature or usage of trade, is the equivalent of any other like unit; or (B) goods that by agreement are treated as equivalent.

(19) "**Genuine**" means free of forgery or counterfeiting.

(20) "**Good faith**," except as otherwise provided in Article 5, means honesty in fact and the observance of reasonable commercial standards of fair dealing.

(21) "**Holder**" means: (A) the person in possession of a negotiable instrument that is payable either to bearer or to an identified person that is the person in possession; or (B) the person in possession

of a document of title if the goods are deliverable either to bearer or to the order of the person in possession.

(22) "**Insolvency proceeding**" includes an assignment for the benefit of creditors or other proceeding intended to liquidate or rehabilitate the estate of the person involved.

(23) "**Insolvent**" means: (A) having generally ceased to pay debts in the ordinary course of business other than as a result of bona fide dispute; (B) being unable to pay debts as they become due; or (C) being insolvent within the meaning of federal bankruptcy law.

(24) "**Money**" means a medium of exchange currently authorized or adopted by a domestic or foreign government. The term includes a monetary unit of account established by an intergovernmental organization or by agreement between two or more countries.

(25) "**Organization**" means a person other than an individual.

(26) "**Party**", as distinguished from "third party", means a person that has engaged in a transaction or made an agreement subject to [the Uniform Commercial Code].

(27) "**Person**" means an individual, corporation, business trust, estate, trust, partnership, limited liability company, association, joint venture, government, governmental subdivision, agency, or instrumentality, public corporation, or any other legal or commercial entity.

(28) "**Present value**" means the amount as of a date certain of one or more sums payable in the future, discounted to the date certain by use of either an interest rate specified by the parties if that rate is not manifestly unreasonable at the time the transaction is entered into or, if an interest rate is not so specified, a commercially reasonable rate that takes into account the facts and circumstances at the time the transaction is entered into.

(29) "**Purchase**" means taking by sale, lease, discount, negotiation, mortgage, pledge, lien, security interest, issue or reissue, gift, or any other voluntary transaction creating an interest in property.

(30) "**Purchaser**" means a person that takes by purchase.

(31) "**Record**" means information that is inscribed on a tangible medium or that is stored in an electronic or other medium and is retrievable in perceivable form.

(32) "**Remedy**" means any remedial right to which an aggrieved party is entitled with or without resort to a tribunal.

(33) "**Representative**" means a person empowered to act for another, including an agent, an officer of a corporation or association, and a trustee, executor, or administrator of an estate.

(34) "**Right**" includes remedy.

(35) "**Security interest**" means an interest in personal property or fixtures which secures payment or performance of an obligation. "Security interest" includes any interest of a consignor and a buyer of accounts, chattel paper, a payment intangible, or a promissory note in a transaction that is subject to Article 9.

"Security interest" does not include the special property interest of a buyer of goods on identification of those goods to a contract for sale under Section 2-505, the right of a seller or lessor of goods under Article 2 or 2A to retain or acquire possession of the goods is not a "security interest", but a seller or lessor may also acquire a "security interest" by complying with Article 9. The retention or reservation of title by a seller of goods notwithstanding shipment or delivery to the buyer under Section 2-401 is limited in effect to a reservation of a "security interest." Whether a transaction in the form of a lease creates a "security interest" is determined pursuant to Section 1-203.

(36) "**Send**" in connection with a writing, record, or notice means: (A) to deposit in the mail or deliver for transmission by any other usual means of communication with postage or cost of transmission provided for and properly addressed and, in the case of an instrument, to an address specified thereon or otherwise agreed, or if there be none to any address reasonable under the circumstances; or (B) in any other way to cause to be received any record or notice within the time it would have arrived if properly sent.

(37) "**Signed**" includes using any symbol executed or adopted with present intention to adopt or accept a writing.

(38) "**State**" means a State of the United States, the District of Columbia, Puerto Rico, the United States Virgin Islands, or any territory or insular possession subject to the jurisdiction of the United States.

(39) "**Surety**" includes a guarantor or other secondary obligor.

(40) "**Term**" means a portion of an agreement that relates to a particular matter.

(41) "**Unauthorized signature**" means a signature made without actual, implied, or apparent authority. The term includes a forgery.

(42) "**Warehouse receipt**" means a receipt issued by a person engaged in the business of storing goods for hire.

(43) "**Writing**" includes printing, typewriting, or any other intentional reduction to tangible form. "**Written**" has a corresponding meaning.

FORMAL REQUIREMENTS.

Uniform Law Source: Uniform Commercial Code: Section 2A-201 (1998 Official Text).

Definitional Cross References. Section 102: "Agreement"; "Authenticate"; "Contract"; "Copy"; "Information"; "License"; "Merchant"; "Notice"; "Party"; "Receive"; "Record"; "Term". Section 114: "Reason to know".

Official Comments:

1. *Scope of the Section.* This section requires an authenticated record for enforceability of certain agreements. The requirement is especially important in transactions in information because of the intangible nature of the subject matter and the split of interests in licenses, with ownership of rights in one party and contractual rights or privileges in the other. The section blends Uniform Commercial Code concepts with common law approaches. Failure to comply with the requirements of this section does not make the contract void, it merely precludes a party from relying on it as a defense or to bring a cause of action.

2. *Relationship to Federal Law.* Federal intellectual property law may in some cases require formalities for enforceability of a contract. These not affected by this section. The Copyright Act, for example, requires a signed writing for some transactions, but not for a nonexclusive license. *See e.g., Radio Television Espanola S.A. v. New World Entertainment*, -- F.3d. -- (9th Cir. 1999) (faxes, letters and memos referencing a licensing deal were insufficient to satisfy federal law). As federal law, copyright law controls when applicable. Where both apply, state law cannot permit enforceability if federal law does not, but state law can require additional formalities. As a general rule, state law controls for non-exclusive licenses.

3. *Basic Rule.* Subject to stated exceptions, under subsection (a), an agreement requiring payment of a contract fee of $5,000 or more is not enforceable by way of action or defense unless there is an authenticated record indicating that a contract was formed and reasonably describing the subject matter or copy. This basic standard focuses formality requirements on transactions of commercial significance without requiring unnecessary formality in the numerous small transactions that occur in ordinary commerce.

The payments must be *required* under the agreement assuming that full performance occurs. A royalty provision that might (or might not) ultimately yield millions of dollars of revenue is not within this rule unless the agreement calls for a minimum payment of $5,000 or more. Similarly, the existence of an option that might trigger an additional payment is not relevant unless the payment is mandatory.

a. *Over One Year Rule.* For a license, a record is required only if the threshold dollar amount is met and the license grants rights for an agreed term of more than one year. This reflects the common law approach to statute of frauds, which centers on the duration of the contract, and the fact that for licenses duration of rights is a significant, independent measure of value. A license for a perpetual duration, whether that duration comes from an express term or from the default rules of this Act, exceeds one year as would any license that designates a term longer than one year even if the license permits termination by a party for a reason before that time. On the other hand, a license for an indefinite term subject to termination at will does not exceed one year duration. An option to extend the duration of the license does not bring the contract within the statute unless the option is mandatory or is effectively mandatory because of the economics involved.

b. *Record Required.* The record, when required, must: 1) indicate that a contract was formed, 2) reasonably identify the copy or subject matter involved, and 3) have been authenticated by the party against whom the contract is asserted. No other particular formalities or form are required.

This section does not require that the record be retained or contain all material terms of the contract or even be designated as a contract. Nor must such material terms as are required be precisely stated. All that is required is that the writing afford a basis for believing that the offered oral evidence rests on a real agreement. A memorandum that fulfills the stated conditions suffices. The record must reasonably indicate that a contract was formed, and not merely that a contract was

being negotiated. This section does not establish contract terms: if this section is met, terms can be determined under other sections of this Act (see e.g., Section 301).

Merely because a record that satisfies this section exists does not establish that a contract exists. Fulfilling this section merely allows a party to pursue its assertion that a contract allows it to bring an action or raise a defense. For the contract to exist, contract formation concepts must be met. For example, while a record need not describe all of the scope of a license, even if it meets the standards here there is no contract if there is a material disputes about scope. Section 202. Satisfying the statute of frauds is merely a gateway to being able to have a court consider whether or not there is a contract.

c. *Authenticated.* Under the general rule, and subject to exceptions provided in this section, the record must be authenticated by the party to be bound. A party can prove the existence of an authenticated record by showing that a procedure existed by which an authenticated record must necessarily have been made in order for the party to have proceeded in use of the information or another activity.

d. *Subject Matter or Copy.* The record must describe the copy or subject matter covered by the alleged contract. "Subject matter" refers to defining to which information the agreement refers. This does not require a description of the scope of a license. For example, a reference to a film clip taken from the motion picture "Wise Choices" satisfies this section even though the record does not describe what rights were granted. Determining the full scope and terms is addressed under other sections of this Act, including Section 307. Similarly, a record is adequate for this section if it refers to one copy of the word processing software "Word Perfection." There is no requirement that the record describe the quantity or contract fee or, even, the specific copy since this description adequately meets the "subject matter" requirement.

Subsection (b) provides a rule adapted from Uniform Commercial Code § 2-201 (1998 Official Text). The required designation of copy or subject matter, if met, cannot be defeated for purposes of the statute of frauds, by showing that the designation was incorrect. However, the contract is not enforceable beyond the number of copies or subject matter shown in the authenticated record.

4. *Exceptions to the Basic Rule.* There are four cases in which this section permits exceptions to the basic rule. These are based on the conclusion that transactional circumstances render the protective policies of a statute of frauds moot.

a. *Partial Performance.* Under subsection (c)(1),one exception occurs with tender of performance by one party and acceptance or access by the other. These acts by both parties adequately establish that a contract may exist and the authenticated record required under subsection (a) is unnecessary. This section rejects the Article 2 rule and holds that partial performance satisfies the statute of frauds in full, rather than solely with respect to the performance itself. Parol evidence rules and ordinary contract interpretation principles protect against unfounded claims of extensive contract obligations based on a tender and acceptance of limited performance.

The exception in subsection (c)(1) requires tender and acceptance or access. A party relying on the exception must show both. Mere possession of a copy does not meet this exception, which depends on there being an authorized source for the copy. Similarly, the performance tendered and accepted must be sufficient to show a contract exists and cannot consist of minor acts of ambiguous nature.

Part performance under this subsection only takes away the formalities barrier and allows the party to attempt to prove the existence of a contract. It does not prove that a contract exists or, if it does, which terms govern. These must be established under other provisions of this Act. For example, in the case of an alleged contract to develop and deliver three modules of a new program, tender and acceptance of one module satisfies the formalities required by the section, but whether there was actually a contract covering three modules must be proven by the party claiming it.

b.. *Judicial Admissions.* A record is not needed if the party charged with the contract obligations admits in proceedings that a contract exists. The admission confirms the existence of the contract to the extent of the subject matter admitted. Consistent with the rule in Uniform Commercial Code Article 2 (1998 Official Text), however, the admission satisfies the section only to the extent of the contract subject matter or copies admitted.

c. *Confirming Memoranda.* Subsection (d) follows the rule in U.C.C. § 2-201 (1998 Official Text). Between merchants, failure to answer a record that confirms a contract within ten days of receipt of the record satisfies this section with respect to both parties. This validates practice in many industries where the volume or nature of the transactions make it impossible to prepare and receive assent to records as part of making the initial agreement. The confirming memorandum places the other party on notice that a contract has been formed. It must object to the existence of a contract if one, in fact, does not exist.

The memorandum removes the statutory bar to enforcement. The only effect, however, is to take away from the party who fails to answer, the defense of this section. The burden of persuading a trier of fact that a contract was actually made prior to the confirmation is unaffected by this rule. The confirming memorandum does not of itself establish the existence or terms of the contract, which terms must be established under other provisions of this Act.

5. *Other Agreements.* Subsection (e) confirms the enforceability of trading partner or similar agreements that alter the formal requirements of this section with respect to covered transactions. The parties can agree in an authenticated record to conduct business without additional authenticated writings. That agreement satisfies the statute and the policies of requiring minimal indication that a contract was formed. The purpose of a statute of frauds is to prevent fraud, not to inhibit the development of reasonable commercial practices between parties.

6. *Other Laws.* Subsection (f) clarifies that the formalities required by this section supplant formalities required under other laws relating to transactions within this Act. This rule is applicable only with respect to state law. In many licenses, federal law requires more stringent formalities. For example, the Copyright Act requires that an exclusive copyright license be in a writing and makes non-exclusive licenses that are not in a writing subject to subsequent transfers of the copyright.

1-202. Notice; Knowledge.

(a) Subject to subsection (f), a person has "**notice**" of a fact if the person: (1) has actual knowledge of it; (2) has received a notice or notification of it; or (3) from all the facts and circumstances known to the person at the time in question, has reason to know that it exists.

(b) "**Knowledge**" means actual knowledge. "Knows" has a corresponding meaning.

(c) "**Discover**", "**learn**", or words of similar import refer to knowledge rather than to reason to know.

(d) A person "**notifies**" or "**gives**" a notice or notification to another person by taking such steps as may be reasonably required to inform the other person in ordinary course, whether or not the other person actually comes to know of it.

(e) Subject to subsection (f), a person "**receives**" a notice or notification when: (1) it comes to that person's attention; or (2) it is duly delivered in a form reasonable under the circumstances at the place of business through which the contract was made or at another location held out by that person as the place for receipt of such communications.

(f) Notice, knowledge, or a notice or notification received by an organization is effective for a particular transaction from the time it is brought to the attention of the individual conducting that transaction and, in any event, from the time it would have been brought to the individual's attention if the organization had exercised due diligence. An organization exercises due diligence if it maintains reasonable routines for communicating significant information to the person conducting the transaction and there is reasonable compliance with the routines. Due diligence does not require an individual acting for the organization to communicate information unless the communication is part of the individual's regular duties or the individual has reason to know of the transaction and that the transaction would be materially affected by the information.

Uniform Law Source: Uniform Commercial Code: Sections 2-204; 2-305(4); 2A-204 (1998 Official Text).

Definitional Cross References: Section 102: "Agreement"; "Contract"; "Contract fee"; "Contractual use term"; "Deliver"; "Electronic agent"; "Information"; "Licensee"; "Licensor"; "Party"; "Record"; "Receive"; "Scope"; "Term".

Official Comments:

1. *Scope of Section.* This section describes basic contract formation rules and is subject to specific rules on offer and acceptance in subsequent sections of this Act. This Act separates the issue of whether a contract was formed from the issue of contract. terms This section deals with formation. Sections 208, 209 and 210 deal with establishing the terms. Often, of course, the same acts form a contract and define its terms.

2. *Manner of Formation.* Subsection (a) follows Uniform Commercial Code § 2-204 (1998 Official Text), the *Restatement (Second) of Contracts* 19, and common law in most states. A contract can be formed in any manner sufficient to show agreement, oral, written, by conduct or inaction or otherwise. Of course, no contract is formed without an intent to contract. The rule in this section does not impose a contractual relationship where none was intended. In determining whether conduct or words establish a contract or whether they do not, courts must look to the entire circumstances, including any applicable usage of trade or course of dealing.

Subsection (a) recognizes that an agreement can be formed by operations of electronic agents. This is important for sustaining electronic commerce and gives force to choices made by a party to use an electronic agent for formation of a contract. The agent's operations bind the person who deployed the agent for that purpose.

3. *Time of Formation.* Subsections (b) follows U.C.C. § 2-204 (1998 Official Text). It confirms that, if the intent to do so exists, a contract can be formed even though the exact time of its formation is not known or there are terms left open or are deferred for delineation by one party. This rule reflects a dominant principle in contract law, focusing courts and parties on the commercial context and whether there was an intent to contract, rather than on whether form or format comply with abstract concepts of when a contract should be recognized.

4. *Open Terms and Layered or Rolling Transactions.* Subsection (c) recognizes that if the parties intend to enter a binding agreement, that agreement is binding despite missing or otherwise open terms so long as any reasonable basis exists for granting a remedy in the event of breach. This rule does not apply if the parties do not intend to be bound unless or until the remaining terms are agreed. This rule exists under Article 2 and common law. *See Evolution Online Systems, Inc. v. Koninklijke Nederlan N.V.,* 145 F.3d 505 (2nd Cir. 1998) ("Under New York contract law, parties may enter into a contract orally even though they contemplate later memorializing their agreement in writing. If, however, the parties do not intend to be bound absent a writing, they will not be bound until a written agreement is executed."); *Winston v. Mediafare Entertainment Corp.,* 777 F.2d 78 (2d Cir.1986).

There must be an intent by both parties to be bound. If that intent exists, enforceability does not require certainty on all terms, what the parties were to do, what obligations they assumed, what acts they agreed to perform, or what damages arise on breach. Rather, commercial standards can apply to these questions, reflecting the fact that in many contracts terms are defined over time, rather than on the occurrence of one specific event. Contract formation is a process, rather than a single event. Being bound at one point subject to changes and further agreement is a common circumstance in commerce. However, as a matter of fact, the more terms the parties leave open, the less likely it is that they intended to be bound.

Subsection (c) assumes a difference between preliminary negotiations and actions or statements made with intent to be bound even though terms are left open. If parties intend a contract, it can be formed despite terms remaining to be agreed and left open. On the other hand, if there is no intent to contract, no contract exists and this Act does not create one.

This subsection lays a foundation for the layered contracting that typifies many areas of commerce and is recognized Uniform Commercial Code 2-204 (1998 Official Text), as well as in the common law and practice of most states. The foundation laid here is further developed in Sections 208, 209 and 305. Any concept that contracts arise at one single point in time and that this single event defines all terms is not consistent with commercial practice. Contracts are often formed over a period of time, and terms are often developed during performance, rather than before any performance occurs. Often the parties expect to adopt records later and that expectation itself is the agreement. Rather than modifying an existing agreement, these are part of the agreement itself. Treating later terms as a proposed modification is appropriate only if the deal has, in commercial understanding of both parties, been closed with no reason to know new terms would be provided. If the parties did not intend to be bound to any contract unless terms were agreed to, subsection (e) gives guidance for unwinding the relationship.

During the time in which terms in a layered contract are developed or to be proposed, it is not appropriate to the apply default rules of this Act. The default rules apply only if the agreement of the parties does not deal with the subject matter of the rule. Agreement may be found in express terms, or through application of usage of trade or course of dealing, or inferred from other conduct of the parties. In layered contracting, the agreement is that there are no terms on the undecided issues until they are made express by the parties. Applying a default rule would be applying the rule despite contrary agreement, rather than when no such agreement exists.

5. *Disagreement on Material Terms: Scope.* The existence of a contract requires a determination of intent to contract, objectively measured. In some cases, the circumstances clearly indicate that no intent to contract exists. Subsection (d) sets out one such context. A material disagreement about an important (material) term indicates that no intent to enter a contract exists. The "scope" of the license is one such term. It goes to the fundamentals of the transaction, i.e., what the licensor intends to transfer and what the licensee expects to receive. Indeed, in many respects, the scope is the product. Disagreements about this fundamental issue indicate fundamental failure to agree on a contract. The reference in subsection (d) to disagreement, of course, relates to this type of failure to agree and does not refer to a dispute about the meaning of a term.

6. *Failure to Agree.* Subsection (e) follows Uniform Commercial Code § 2-305(4) (1998 Official Text). While many cases involve layered contracting, in some cases, the parties intend not to be bound

unless they agree to terms later. Subsection (e) states rules that apply where the parties condition agreement on subsequent specification of terms, but that later determination does not occur.

The basic theme is that parties are returned to the status that would have existed in the absence of initial agreement. As indicated in this subsection, there is an obligation to return copies or information received during the preliminary period. In addition, if the parties agreed to restrictions on the information or copies, those contractual use terms continue as to that information or those copies. They do not extend to authorized copies obtained from other sources. For example, a preliminary agreement containing use restrictions regarding data compression software from a wholesale provider of the software remains binding, but may not preclude the licensee from an agreement with another source of a copy of the same software, if the first transaction failed to create a binding agreement.

1-203. Lease Distinguished from Security Interest.

(a) Whether a transaction in the form of a lease creates a lease or security interest is determined by the facts of each case.

(b) A transaction in the form of a lease creates a security interest if the consideration that the lessee is to pay the lessor for the right to possession and use of the goods is an obligation for the term of the lease and is not subject to termination by the lessee, and: (1) the original term of the lease is equal to or greater than the remaining economic life of the goods; (2) the lessee is bound to renew the lease for the remaining economic life of the goods or is bound to become the owner of the goods; (3) the lessee has an option to renew the lease for the remaining economic life of the goods for no additional consideration or for nominal additional consideration upon compliance with the lease agreement; or (4) the lessee has an option to become the owner of the goods for no additional consideration or for nominal additional consideration upon compliance with the lease agreement.

(c) A transaction in the form of a lease does not create a security interest merely because: (1) the present value of the consideration the lessee is obligated to pay the lessor for the right to possession and use of the goods is substantially equal to or is greater than the fair market value of the goods at the time the lease is entered into; (2) the lessee assumes risk of loss of the goods; (3) the lessee agrees to pay, with respect to the goods, taxes, insurance, filing, recording, or registration fees, or service or maintenance costs; (4) the lessee has an option to renew the lease or to become the owner of the goods; (5) the lessee has an option to renew the lease for a fixed rent that is equal to or greater than the reasonably predictable fair market rent for the use of the goods for the term of the renewal at the time the option is to be performed; or (6) the lessee has an option to become the owner of the goods for a fixed price that is equal to or greater than the reasonably predictable fair market value of the goods at the time the option is to be performed.

(d) Additional consideration is nominal if it is less than the lessee's reasonably predictable cost of performing under the lease agreement if the option is not exercised. Additional consideration is not nominal if: (1) when the option to renew the lease is granted to the lessee, the rent is stated to be the fair market rent for the use of the goods for the term of the renewal determined at the time the option is to be performed; or (2) when the option to become the owner of the goods is granted to the lessee, the price is stated to be the fair market value of the goods determined at the time the option is to be performed.

(e) The "remaining economic life of the goods" and "reasonably predictable" fair market rent, fair market value, or cost of performing under the lease agreement must be determined with reference to the facts and circumstances at the time the transaction is entered into.

OFFER AND ACCEPTANCE IN GENERAL.

Uniform Law Source: Restatement (Second) of Contracts § 19; Uniform Commercial Code: 2A-206; 2-206 (1998 Official Text).

Definitional Cross References. Section 102: "Access Materials"; "Copy"; "Contract"; "Delivery"; "Electronic"; "Electronic message"; "Licensee"; "Licensor"; "Information"; "Notifies"; "Party"; "Receive"; "Term".

Official Comments:

1. *Scope of Section.* This section states general rules on offer and acceptance. Sections 204 and 205 concern acceptances that vary the offer and conditional offers or acceptances and, when applicable, control over this section to the extent of a conflict.

2. *Reasonable Methods of Acceptance.* A party has a right to control the terms for accepting its offer, if it does so expressly. In many cases, this will occur through insistence on its terms or on the method of expressing acceptance. However, if an offeror does not limit the method of acceptance, any reasonable manner of acceptance suffices. This rule reflects commercial and ordinary practice and

follows the rule in *Restatement (Second) of Contracts* § 19 and Uniform Commercial Code § 2-206 (1998 Official Text). It accommodates new methods of communication as they develop.

3. *Shipment or Promise to Ship.* Paragraph (2) follows Uniform Commercial Code § 2-206(1)(b) (1998 Official Text) and should be interpreted consistent with that section. Either shipment or a prompt promise to ship is made a proper means of acceptance of an offer looking to current shipment, unless the offer otherwise provides. The second sentence accommodates the fact that, in some cases, it is useful commercially to accommodate a request for product with a shipment that may not fully conform. In such cases, there is not an acceptance of the offer if the shipping party notifies the offeror (licensee) that the shipment is offered only as an accommodation to the licensee.

4. *Beginning of Performance.* The beginning of performance by an offeree can be effective as an acceptance. Paragraph (3) follows Uniform Commercial Code § 2-206 (1998 Official Text) to limit that effect so as to prevent abuse. Under this section, beginning performance, even if a reasonable means of acceptance, requires notice to the offeror that there has been acceptance. If this notice is not given in a reasonable time, the offeror can treat its offer as having lapsed before acceptance. To be effective as an acceptance, beginning of performance must unambiguously indicate an intent to be bound.

5. *Electronic Responses.* Paragraph (4) clarifies the situation where electronic messages and performances constitute the acceptance. It adopts a time of receipt rule for the effectiveness of an electronic acceptance or an electronic performance. The performance may entail making access available to the other party. In this case, acceptance by performance occurs when the access is enabled or access materials are received by the offeror.

1-204. Value.

Except as otherwise provided in Articles 3, 4, [and] 5, [and 6], a person gives value for rights if the person acquires them: (1) in return for a binding commitment to extend credit or for the extension of immediately available credit, whether or not drawn upon and whether or not a charge-back is provided for in the event of difficulties in collection; (2) as security for, or in total or partial satisfaction of, a preexisting claim; (3) by accepting delivery under a preexisting contract for purchase; or (4) in return for any consideration sufficient to support a simple contract.

ACCEPTANCE WITH VARYING TERMS.

Uniform Law Source: Uniform Commercial Code: Section 2-207.

Definitional Cross References. Section 102: "Contract"; "Delivery". "Merchant"; "Give notice"; "Party"; "Receive"; "Seasonable"; "Term". Section 112: "Manifest assent". Section 114: "Reasonable time."

Official Comments:

1. *Scope of Section.* This section deals with contract formation by offer and acceptance where the acceptance contains terms that vary the offer, but neither the offer nor the acceptance is made expressly conditional on acceptance of all its own terms. Conditional offers and acceptances are covered in Section 205.

2. *Basic Rule.* Subsection (a) recognizes that, when neither the offer nor the acceptance are expressly conditioned on acceptance of their own terms, an acceptance may form a contract even though it contains terms that do not match the offer. Ancient common law followed a "mirror image" rule that required a perfect match between an offer and acceptance. That rule was rejected in Article 2 and no longer is followed as common law in most states. It ignores commercial practice. Subsection (a) follows and clarifies the rule established in Uniform Commercial Code § 2-207 (1998 Official Text).

There must be an intent to contract and enough similarity between the expressed acceptance and the offer to conclude that the offer was accepted. For this to occur, a record containing the acceptance with the varying terms must be a *definite* expression of *acceptance.* Anything less is at most a counter-offer and perhaps nothing more than negotiation. This condition for treating a varying "acceptance" as creating a contract is seldom met except in cases involving routine use of standard form purchase orders or invoices. In most other cases, an expression containing varying terms constitutes a counter-offer, rather than an acceptance.

Subsection (a) also recognizes that, no matter how labeled, a purported acceptance is not an acceptance in law if it materially alter the terms of the offer. This rule is implicit in Article 2 and in commercial practice. One does not accept an offer by proposing materially different terms.

3. *Material Alteration.* A material alteration of an offer by a purported acceptance precludes contract formation based on the purported acceptance. If a contract is formed, it must be based on other facts, such as conduct of the parties that establishes a contract or circumstances that clearly show that one party accepted the terms of the other.

What is a material alteration depends on the context. Comments to Article 2 describing a nonmaterial alteration refer to "an acceptance [that] adds further minor suggestions or proposals." The issue must be judged by what degree of acceptable variation parties might reasonably expect in light of applicable usage of trade and course of dealing. A material change is one that would result in surprise or hardship if incorporated without express agreement by the other party. An "acceptance" that seeks to alter basic elements of the bargain proposed by the offer is not an acceptance and, in the absence of conduct creating a contract, no contract is formed by that "acceptance" unless the new terms are accepted by the other party. Standards of materiality in this context include whether the additional terms involve unreasonable surprise measured against the commercial context, including usage of trade and course of dealing, or whether they so change the effect of the other terms of the offer such as to significantly alter the bargain reached. Any change in an offer that is expressly described as conditional on acceptance of all of its terms is a material change.

4. *Immaterial Alteration.* If an acceptance does not match the offer, but also does not materially vary it, the acceptance creates a contract under subsection (d) based on the terms of the offer and other terms as indicated. Section 210 does not apply because the contract is formed by offer and acceptance, not conduct. Under subsection (d), conflicting terms contained in the acceptance are excluded. A conflicting term is one that covers the same subject matter of another term, but in a different way. Subsection (d) allows for inclusion of non-material *additional* terms in the acceptance in a transaction between merchants unless the offeror timely objects to those terms. An additional term is one that covers a subject not addressed in the terms of the offer; for subsection (d) to apply, the term must not materially alter the offer .

1-205. Reasonable time; Seasonableness.

(a) Whether a time for taking an action required by [the Uniform Commercial Code] is reasonable depends on the nature, purpose, and circumstances of the action.

(b) An action is taken seasonably if it is taken at or within the time agreed or, if no time is agreed, at or within a reasonable time.

CONDITIONAL OFFER OR ACCEPTANCE.

Definitional Cross References. Section 102: "Agreement"; "Contract"; "Party"; "Standard form"; "Term". Section 112: "Manifestation of assent".

Official Comments:

1. *Scope of Section.* This section deals with conditional offers or acceptances. It supersedes the prior sections on offer and acceptance on these issues.

2. *Basic Rule.* A person can state and insist on preconditions for its offer without being forced into a different contractual relationship because the conditions are ignored. That basic contract law principle is stated in subsection (a). The most common conditional offer or acceptance limits the other party to acceptance of all of its terms or to rejection of the offer. No principled view of contract law precludes a party from insisting on such conditions and precluding a contract on other terms. The conditioning language need not be in a record or stated in any specific form of language.

3. *Standard Forms.* The basic rule does not change merely because the conditions are in a standard form. Conditional standard forms state the terms under which a party is willing to enter a transaction. The mere fact that the conditions are not tailored to each individual deal does not lessen their effect. Standardization is an ordinary and efficient means of doing business.

4. *Battle of Standard Forms.* Subsection (b) deals with a limited situation where both parties use standard forms for offer and acceptance *and* one or both are conditioned on acceptance of all terms in the form. In that case, if the forms disagree on terms, there is no contract based on the standard form records since the conditions for the offer being accepted have not been met. However, in practice, it is often true that the parties nevertheless act as if a contract exists.

Under subsection (b), the conditional language in a standard form is enforced only if a party proposing the form acts in a manner consistent with the language in its form. This means that there are two scenarios recognized in this "battle of forms." The first is where behavior is inconsistent with the conditions. In this case, if the party whose form is conditional on acceptance of its terms by its conduct ignores that condition, the condition itself is not enforced and a contract is created under the section on varying terms.

The second scenario is where the party's behavior is consistent with its conditional terms, such as by refusing to perform, refusing to permit performance, or refusing to accept the benefits of the contract, until the terms are accepted. Here, there is no contract by the exchange of forms unless the one party accepted the other party's terms. However, if a party accepts the terms, under paragraph (b)(2), the

contract is formed based on those terms, except to the extent they conflict with expressly agreed terms on price or quantity.

Illustration 1. Licensee sends a standard purchase order form indicating that its order is conditional on the Licensor's assent to the terms on the form. Licensor ships with an invoice or other documents conditioning the contract on assent to its terms. Purchaser accepts shipment. Neither party acted consistent with the language of condition. A contract exists but neither condition is enforceable. Section 204 or 210 applies.

Illustration 2. In Illustration 1, Licensor refuses to ship unless Purchaser agrees to the Licensor's terms. Until that occurs, there is no contract. A similar result occurs if Licensor ships, but includes in the information a code that prevents use of the information unless the Purchaser assents to the Licensor's terms.

Illustration 3. In Illustration 1, Licensor ships pursuant to a conditional form, but when the shipment arrives, Purchaser refuses it. In a telephone conversation, Licensor agrees to Purchaser's terms. Until that agreement, there is no contract; Purchaser acted in a manner consistent with its conditional language.

1-206. Presumptions. OFFER AND ACCEPTANCE; ELECTRONIC AGENTS

Whenever [the Uniform Commercial Code] creates a "presumption" with respect to a fact, or provides that a fact is "presumed," the trier of fact must find the existence of the fact unless and until evidence is introduced that supports a finding of its nonexistence.

OFFER AND ACCEPTANCE; ELECTRONIC AGENTS.

Definitional Cross References. Section 102: "Agreement"; "Contract"; "Electronic agent"; "Information"; "Party"; "Person"; "Term". Section 114: "Reason to know".

Official Comments:

1. *Scope of the Section.* This section deals with contracts formed by an interaction between electronic agents, or between an individual (acting on the individual's own behalf or for another person such as a company) and an electronic agent.

2. *Interaction of Electronic Agents.* An interaction of electronic agents creates a contract if the parties use the agents to achieve that type of result and the operations of the electronic agents indicate that a contract exists. Conduct, even if automated, can create a contract. In this context, the test for whether a contract is formed focuses on the operations of the agents. The basic test is whether those operations indicate that a contract is formed, such as by sending and receiving the benefits of the contract, initiating orders, or indicating in records that a contract exists. The terms of the contract are determined under Section 208 and 209 as applicable.

3. *Electronic Mistake and Fraud.* Subsection (a) makes clear that applying restrictions analogous to common law concepts of fraud and mistake is appropriate in this automated context to prevent abuse or clearly unexpected results. Courts applying these concepts may refer to cases involving mistake or fraud doctrine even though an electronic agent cannot actually be said to have been misled or mistaken. Of course, parties may agree to allocate the risk of mistake or fraud in an agreement. In cases involving a consumer, Section 214 provides a special application of mistake theory in automated contracts.

Assent does not occur if the operations are induced by mistake, fraud or the like, such as where a party or its electronic agent manipulates the programming or response of the other electronic agent in a manner akin to fraud. Such acts, vitiate the inference of assent which would occur through the normal operations of the agent. Similarly, the inference is vitiated if because of aberrant programming or through an unexpected interaction of the two agents, operations indicating the existence of a contract occur in circumstances that are not within the reasonable contemplation of the person who selected either electronic agent for use. In such cases, the circumstances are analogous to mutual mistake.

4. *Interaction of Human and Electronic Agent.* Contracts may be formed by an interaction of an individual (human being) and an electronic agent. Subsection (b) does not try to define all cases where this can occur. It merely describes one setting in which the interaction entails two elements:1) an electronic agent is programmed to make contracts, and 2) an individual having the ability to not do so, engages in conduct or makes a statement with reason to know that this will cause the electronic agent to provide the benefits of the contract or otherwise indicate acceptance. If the individual is dealing with an electronic agent, not all statements or actions by the individual can be reacted to by the electronic agent. A contract is formed if the human makes statements or engages in conduct that indicate assent. Statements purporting to alter or vitiate agreement to which the electronic agent cannot react are ineffective.

Illustration 1. Tootie is a computer program used to receive and accept orders at Home Shop. A voice instructs the customer to indicate a credit card number, the item number, quantity, customer's location, and other data. In one transaction, customer, after entering the data, verbally states that he will only accept the information if there is a 120 day "no questions" refund right. Otherwise: "I don't want the silly things." Customer has reason to know that the program cannot react to this verbal condition. There is a contract. The verbal condition or term is ineffective.

Illustration 2. Officer dials the telephone information system using his company credit card. A computerized voice states: "If you would like us to dial your number, press "1", there will be an additional charge of $1.00. If you would like to dial yourself, press "2". Officer states into the phone that the company will not pay the $1.00 additional charge, but will pay .50. Having stated these conditions, Officer strikes "1." The computer dials the number, having located it in the database. User's "counter offer" is ineffective. The charge to user's company includes the additional $1.00.

2-207 FORMATION: RELEASES OF INFORMATIONAL RIGHTS.

Definitional Cross References. Section 102: "Agreement"; "Informational rights"; "License"; "Party"; "Record"; "Release". Section 112: "Manifesting assent."

Official Comments:

1. *Scope of Section.* This section deals with the enforceability and duration of a release. A release is an agreement that the releasing party will not object to, or exercise any remedies to limit, the use of information or informational rights. While a release is a license, it does not contain any significant, affirmative obligation by the releasing party to enable the other party's use of the information.

2. *Basic Rule.* A release is enforceable without consideration if it is in a record to which the releasing party agrees, by manifesting assent or otherwise. This includes all means of recording assent and all forms of records, such as by filmed assent. The rule clarifies the enforceability of releases in a record, but does not alter other law making releases enforceable, whether or not supported by consideration.

Illustration: In Internet "chat room" and "list service" systems, participation often requires permission by the participant to allow use of comments or materials submitted. If the relationship granting that permission is supported by assent and consideration (e.g., one party grants the right to use the service in return for the release), the release is enforceable under ordinary contract law principles of offer and acceptance. This section makes clear that the release is enforceable without consideration.

3. *Duration.* Duration of a release is determined by the agreement. If there is no agreed duration, Section 308 may apply. However, subsection (b) states a different rule for releases where there is no significant involvement by a party to support the other's use of the information or rights. In these cases, the default rule is that a release is for the duration of the released rights. Of course, the release is effective only with respect to its own terms; a release that allows use of an image in an Internet site does not release rights to other uses of that image.

2-208 ADOPTING TERMS OF RECORDS.

Definitional Cross References. Section 102: "Agreement"; "Contract"; "Copy"; "Party"; "Record"; "Standard form"; "Term". Section 112: "Manifest assent"; "Opportunity to review." Section 114: "Reason to know".

Official Comments:

1. *Scope of Section.* This Act deals separately with conduct that forms a contract and conduct that establishes its terms, although most often the same conduct establishes both. This section is the primary section when a party adopts terms of a record as the terms of a contract. Section 209 limits terms in mass-market licenses and their method of presentation. Section 210 deals with when records do not create terms, but a contract exists because of conduct.

2. *Adopting Terms.* If a party agrees to a record, including by manifesting assent to it, that party adopts the terms of the record as the terms of the contract, whether or not the record is a standard form. There is no difference between adopting terms of a customized record or of a standard form. Standard forms are commonly used in commercial practice and provide efficiencies for both parties.

Treating them in law as less than other contracts would put commercial law in conflict with commercial practice and reduce the efficiencies. Standard forms will increasingly not be the province of only one party to the deal. This section rejects decisions and the rule of *Restatement (Second) of Contracts* 211(3) which hold that a term that is not unconscionable or induced by fraud may be invalidated because a court holds after-the-fact that a party could not have expected it to be in the contract. Absent unconscionability, fraud or similar conduct, subject to Section 209, parties are bound by the terms of the contractual records to which they assent.

a. Knowledge of Terms. As under virtually universal common law, under this Act it is not necessary that the adopting party actually read, understand, or negotiate the terms of a record. Assent to the record encompasses assent to its terms unless the terms are unconscionable.

b. Modes of Assent. A party is bound by the terms of a record only if it agrees to the record, by manifesting assent or otherwise. The party may authenticate (sign) the record. The party's conduct may indicate assent to a record or a contract. Section 112. However, a party cannot manifest assent to a form or other record unless it has had an opportunity to review that form before reacting. The party seeking that assent must ensure that this opportunity is created.

3. *Later Terms: Layered Contracting.* Subsection (2) adopts the concept of layered contracting. While some contracts are formed and their terms fully defined at a single point in time, many transactions involve a rolling or layered process. An agreement exists, but terms are clarified or created over time. That fact is recognized in this section and elsewhere in this Act.

Often, the commercial expectation is that terms will follow or be developed after performance begins. This Act rejects cases that treat contracting as a single event notwithstanding ordinary practice and expectations that terms will follow after an initial agreement or initial performance. It adopts the rule in cases that recognize the commercial reality that terms are often formed over time. See *ProCD, Inc. v. Zeidenberg*, 86 F.3d 1447 (7th Cir. 1996); *Brower v. Gateway 2000, Inc.,* 676 NYS.2d 569 (N.Y.A.D. 1998). Subsection (b) qualifies that rule by requiring as a precondition for later terms, that the parties have reason to know that terms will follow.

Under subsection (2) contract terms can be proposed and later agreed to as part of completing the initial contract, even though provided after the beginning of performance by one or both parties. Such terms are treated as part of the initial contracting process if at the time of initial agreement, the parties had reason to know and, thus, expected that this would occur and that terms of a record to be agreed would provide elaboration of their contract. If, instead, the parties consider the deal to be closed at the outset, subsequently proposed terms from either party are treated as a proposed modification of the agreement, effective only under concepts applicable to such modifications. A third alternative is that the initial agreement leaves terms open and allows one party to specify what those terms are at some later date. There, specifying the terms is, in effect, merely a performance of the contract.

Subsection (2) differs from Section 305 which refers to agreements that give one party or its designate a contract right to specify terms of future performance. In cases governed by Section 305, the party receiving the terms is not presented with a proposal for agreement, since the specified terms are part of the original agreement. Where no further assent is required, under Section 305 the terms to be effective must be proposed in good faith and in accordance with reasonable commercial standards.

Under subsection (2), a layered contracting process occurs if the parties had reason to know that this would occur. Reason to know does not require specific notice or specific language in an original agreement, although such factors may play a role in determining reason to know. It can also be inferred from the entire circumstances, including ordinary practices of which a party is or should be aware. In Section 208, the time over which the record can be proposed is referenced to the expectations of the parties under the reason to know standard. At some point, the deal has been closed, but specifying when this occurs in terms of a fixed time standard is impossible in general commerce. It requires an analysis focused on the context and circumstances.

The standard set out in subsection (2) is also reflected in similar transactions in the mass market under Section 209. Section 209, however, places a time limit on when proposal of the terms must occur and precludes the terms from altering terms that are expressly agreed by the parties.

4. *Right to a Return.* In some cases governed by subsection (2) and in mass-market licenses, if assent is sought after the person paid or delivered or became obligated to pay or deliver, the manifestation of assent is not effective unless the person had a right to a return if it chooses to refuse the subsequently proposed terms. Section 112. This obligation applies in mass market and shrink-wrap transactions where the licensor's performance is merely delivery of a copy with a standard for included, but the rule does not necessarily apply in other commercial contexts where there is merely an expectation that terms will be agreed to (or rejected) at some point during performance. See Section 112. In these contexts, general principles of equity apply to deal with the circumstances where there is a failure to agree and the more specific terms of Section 202(e) give guidance on the obligations that arise where the parties did not intend to have a contract in the absence of agreeing to the later terms.

5. *Adoption of Terms.* Subsection (3) states a principle found in the *Restatement* and in general common law. Assent to a record adopts all of the terms of the record and there is no requirement that the party read or separately assent to each term. Of course, the enforceability of terms is subject to the various doctrines set out in this Act regarding unconscionability, public policy, good faith and the

like. This Act rejects the rule in *Restatement (Second) of Contracts* § 211(3) regarding invalidation of some terms. Concerns about unfair surprise and the like dealt with in that *Restatement* proposal are addressed in this Act in Section 209 and under the doctrine of unconscionability.

2-209 MASS-MARKET LICENSE.

Definitional Cross References. Section 102: "Contract"; "Information"; "Information processing system"; "Informational Rights"; "License"; "Licensor"; "Mass-market license"; "Mass-market transaction"; "Party" "Return"; "Term". Section 112: "Manifest assent".

Official Comments:

1. *Scope of Section.* This section places limits on enforceability of contract terms provided in mass-market licenses, including consumer contracts. The section should be read in connection with Sections 208 and 112.

Many mass-market licenses are presented and agreed at the outset of a transaction; some are presented afterwards. This section deals with both. The costs imposed in subsection (b) provide strong incentives for terms to be presented at the outset when practicable. Many mass-market transactions involve three parties which are also addressed in Section 613.

2. *General Rules.* There are various ways in which terms of a consumer or other contracts can be specified. An agreement unrelated to any record containing specific terms suffices, as would an agreement to terms presented at the start of the relationship, even if the assenting party does not read the terms. In other cases, the parties may agree that the terms or particulars of performance may be specified later by one party. Section 305. This section deals with assent to a standard form record containing terms for a mass market license – either at the outset of the transaction or after the transaction begins. Three limiting concepts govern in this context.

a. Assent and Agreement. A party adopts the terms of a record that is a mass market license only if it agrees to the record, by manifesting assent or otherwise. A party cannot do so unless it had an opportunity to review the record before it assents. This means that the record must be available for review and called to the person's attention in a manner such that a reasonable person ought to have noticed it. Section 112.

Adopting terms of a record under this section is pursuant to Section 208, with the limitations stated in that section. If the terms of the record are proposed after a party commences performance, the terms are effective under these sections only if the party assents and it had reason to know that terms would be proposed. Even if reason to know exists, however, for mass-market licenses, this section requires that the terms be made available not later than the initial use of the information and that, if the mass-market license was not made available before the initial agreement, the person is given a right to a return if it refuses the license.

b. Unconscionability and Fundamental Public Policy. Even if a party adopts the terms of a mass market license, a court may invalidate unconscionable terms. Unconscionability doctrine invalidates terms that are bizarre and oppressive and hidden in boilerplate language. See Section 111. For example, a term in a mass-market license that default under the mass-market contract for $50 software cross defaults all commercial licenses between the parties may be unconscionable, if there was no reason for the licensee to anticipate that breach of the small license would constitute breach of an unrelated larger license negotiated between the parties. Similarly, a clause in a mass-market license that grants a license back of trademarks or trade secrets of the licensee without any discussion of the issue between the parties would ordinarily be unconscionable. A court may also refuse to enforce a term if it violates a fundamental public policy under Section 2B-105(b).

c. Conflict with Agreed Terms. In addition, this section provides that standard terms in a mass-market license cannot alter the terms expressly agreed between the parties to the license. A term is expressly agreed if the parties discuss and come to agreement regarding the issue and the agreement becomes part of the bargain. Paragraph (a)(2) preserves the bargain of the parties. For example, if a librarian acquires software for children under an express agreement that the software may be used in its library network, a term in the license that limits use to a single user computer system conflicts with and is over-ridden by the agreement for a network license.

Similarly, in a consumer contract where the consumer requests a "90 day refund for any or no reason" and the vendor agrees to provide such a refund, the standard terms cannot alter that agreement. Of course, there must be an agreement and it is subject to traditional parol evidence concepts. Additionally, under Section 613 the terms of any publisher's license cannot alter the agreement between the end user and the retailer unless expressly adopted by them as their own agreement. This section rejects the test in *Restatement (Second) of Contracts* § 211(c).

Paragraph (a)(2) preserves the bargain of the parties. For example, if a librarian acquires software for children under an agreement that the software may be used in its library network, a term in the

license that limits use to a single user computer system conflicts with and is over-ridden by the agreement for a network license.

3. *Terms Prior to Payment.* If a mass-market license is presented before a price is paid, this Act follows general law that enforces a standard form contract if the party assents to it. The fact that license terms are non-negotiable or that the contract may constitute a "contract of adhesion" does not invalidate it under general contract law or this Act. A conclusion that a contract is a contract of adhesion may, however, require that courts take a closer look at contract *terms* to prevent unconscionability.

See, e.g., *Klos v. Polske Linie Lotnicze*, 133 F.3d 164 (2d Cir. 1998); *Fireman's Fund Insurance v. M.V. DSR Atlantic*, 131 F.3d 1336 (9th Cir. 1998); *Chan v. Adventurer Cruises, Inc.*, 123 F.3d 1287 (9th Cir. 1997). However, this Act's concepts of manifest assent and opportunity to review address concerns often relevant to such a review or a review for procedural unconscionability. The existence of a license is important to both the licensor and the licensee. The license terms define the product, for example, in distinguishing between single user and network use, consumer use and commercial use, and ordinary private use or rights to public display or performance. Often, the license and its enforcement benefit the licensee, giving it rights that would not be present in the absence of an enforceable license or that could not be exercised without permission of the owner of informational property rights. See, e.g., *Green Book International Corp. v. Inunity Corp.,* -- F. Supp. – (D. Mass. 1998). In that event, the license can allow the licensee to avoid infringement.

4. *Terms after Initial Agreement.* Mass market licenses are sometimes presented after initial general agreement between the ultimate licensee and either the retailer or the licensor-publisher. The contracting format allows contracts between end users and remote parties that control copyright or other interests in the information. Enforceability of the license is important to both parties. Under federal law, a sale of a copy of a copyrighted work does not give the copy owner a number of rights that it may desire.

a. Timing of Assent. Under this Act, agreement to the mass-market record can occur before, but must occur no later than during the initial use of the information. This limits layered contracting in the mass market and reflects customary practices in the software and other industries applicable to that market.

b. Cost Free Return. Under subsection (b), if terms are not made available until after initial agreement, the party being asked to assent must have a right to reject terms with a commensurate right to return the information product acquired. This Act refers to a return right, rather than a right to a refund, because, under developing technologies, this right may apply to either the licensee or the licensor, whichever is asked to assent to the record.

Most decisions enforce contract terms presented in this manner. This subsection enforces terms only if there is assent after a chance to review terms and only pursuant to the rule that a party who rejects terms for information must be given a cost free right to say no. This does not mean that the licensee can reject the license and use the information or that it can return damaged or altered information. The right to a return creates a situation equivalent to that which would have existed if the licensee had a chance to review and rejected the license at the initial agreement. The return right does not apply if the licensee agrees to the license. This return right also does not arise if there was an opportunity to review the license before making the initial agreement.

Exposure to potential liability for expenses of reinstating a customer's system after review, creates an incentive for licensors to make the license or a copy available for review before the initial obligation is created. The return right under this section includes, but differs from the return right in Section 112(e). In this section, it is cost free in that the return requires reimbursement for reasonable costs and, if installation of the information was required to review the license, to reasonable costs in returning the system to its initial condition. The fact that this section states an affirmative right in mass market licenses to a cost free refund does not affect whether under other law outside of this Act, a similar right exists in other contexts.

The expenses incurred in return of the subject matter of the rejected license must be reasonable and foreseeable. The costs of return do not include attorney fees or the cost of using an unreasonably expensive means of return or airplane tickets, lost income or the like unless such expenses are required by instructions of the licensor. The reimbursement right refers to ordinary expenses such as the cost of postage.

Similarly, if expenses are incurred because the information was required to be installed to review the license, expenses chargeable to the licensor must be reasonable and foreseeable. The reference here is to actual, out-of-pocket expenses and not to compensation for lost time or lost opportunity. The expenses do not cover consequential damages.

They must be foreseeable. A party may be reasonably charged with ordinary requirements of a licensee that are consistent with others in the same general position, but is not responsible for losses caused by the particular circumstances of the licensee of which it had no reason to know. A twenty dollar mass market license should not expose the provider to significant loss unless the method of presenting the license can be said ordinarily to cause such loss.

Similarly, it is ordinarily not reasonable to provide recovery of disproportionate expenses associated with eliminating minor and inconsequential changes in a system that do not affect its functionality. On the other hand, the provider is responsible to cover actual expenses that are foreseeable from the method used to obtain assent.

2-210. TERMS OF CONTRACT FORMED BY CONDUCT.

Uniform Law Source: Uniform Commercial Code: Section 2-207 (1998 Official Text).

Definitional Cross References. Section 102: "Agreement"; "Authenticate"; "Contract"; "Court"; "Course of Dealing"; "Course of Performance"; "Information"; "Informational Rights"; "Party"; "Record"; "Term"; "Usage of Trade". Section 112: "Manifesting assent."

Official Comments:

1. *Scope of Section.* This section deals with contracts formed by conduct and not by offer and acceptance or agreement to a record. Of course, most contracts created by conduct also involve exchanged records. If the records or an oral agreement form the contract, this section does not apply. Contracts formed by conduct arise in various settings. One is where the parties begin and complete performance without making an agreement and without reducing their agreement to a record. Another involves a "battle of forms" that, under Sections 204 and 205 did not result in an effective offer and acceptance and neither party agreed to a record signifying terms of agreement, but both parties engaged in conduct indicating that a contract was formed.

2. *Interpret based on Context.* This section requires a court to determine contractual terms by considering all commercial circumstances, including the nature of conduct, the informational rights involved, and applicable trade usage or course of dealing. No hierarchy is established. Given the fluid nature of the context, usage of trade and course of dealing have special importance; as in any other context, these elements of the agreement trump supplemental default rules contained in this Act. Consideration of all these factors requires a practical interpretation of the relationship.

Restatement (Second) of Contracts 202(1) (2) (1981); 2 *Farnsworth, Contracts* 7.10 (1990). Formalistic rules cannot account for the contextual nuances that exist in the rich environment of transactional practice in the computer information industries. This section rejects the so-called "knock-out" rule where terms in writings cancel out being replaced by default rules of this Act; that rule is too rigid for information transactions where contract terms often are essential to define the product and the scope of the grant.

3. *Battle of Forms and Conduct.* Some information transactions involve exchanges of inconsistent standard forms coupled with conduct of both parties indicating the existence of a contract. In these cases, one of two results may occur. The first is that a contract is formed by one or both forms and conduct is irrelevant to that contract either because the forms do not materially disagree or because a conditional offer or acceptance of one party was agreed to or otherwise adopted by the other party. When this occurs, the terms of the resulting contract are not determined within this section. The second possibility is that the records and conduct related to them do not establish a contract because, for example, they materially disagree or the conditions of either or both forms are not met. See Sections 204 and 205. Such cases fall within this section if the conduct of the parties nevertheless creates an enforceable contract. Subsection (a) in such cases directs the court to review the entire circumstances regardless of which form was first received or last sent, but including the terms of the exchanged records and established trade usage, course of dealing, and course of performance as relevant circumstances.

4. *Scope of License.* In information transactions, contract terms relating to the scope of the grant define the product being licensed and lie at the core of the agreement. See Comments to Section 102 (scope). The subject matter (e.g., a copy of software) has entirely different value depending on what rights are granted, but that often cannot be determined from the copy itself (the copy may be license of a single-user or for network use). That being true, it is especially important to give special deference to scope issues in a manner that protects valuable informational rights.

Under subsection (a), among the relevant circumstances is the information or informational rights involved. Where there is a significant disagreement about an important element of scope, a court should be careful to not make a determination that creates rights or imposes obligations beyond those actually agreed by the parties, because that in effect would transfer away valuable property of one party based on a judicial determination made on unclear facts. That argues for rejecting any

expansive interpretation of ambiguous conduct. Absent a clear agreement to the contrary, the court should consider the following principles:

(1) The court should avoid creating a scope that requires the licensor to acquire rights it did not own or have the right to license at the time of contracting, or that would exceed the rights that the licensor then had. Thus, if at the time the contract was created by conduct, the licensor only had the right to grant a license limited to the Southwest United States, the court should avoid interpreting conduct as indicating a scope that includes rights for the East Coast or forcing the licensor into an infringement.

(2) The court should avoid expanding the licensee's rights beyond the actual agreement of the parties. A court needs to understand and effectuate the importance of this issue from the licensor's standpoint, protecting important property rights which it holds. Thus, the mere fact that the licensee may have used the licensed rights in the East Coast should not lead a court to conclude that the bargain must therefore have included those rights. Such an interpretation might encourage infringement as a means of expanding rights.

(3) The court should avoid making the licensee liable for infringement because of conduct exceeding the scope, if such exercise was made at a time when the licensee reasonably and in good faith believed that it was acting within the agreed scope. Good faith conduct by the licensee can be protected in appropriate cases by applying equitable principles without creating a grant that may not have been intended by the licensor.

2-211 PRETRANSACTION DISCLOSURES IN INTERNET.

Uniform Law Source: none.

Definitional Cross References. Section 102: "Computer information"; "Copy"; "Electronic"; "Information"; "License"; "Licensee"; "Licensor"; "Standard form". Section 112(e): "Opportunity to review".

Official Comments:

1. *Scope of Section.* This section deals with pre-transaction disclosures of contract terms in transactions on Internet where the contract is formed on-line for an electronic delivery of information.

2. *Relation to Other Assent Rules.* This section provides guidance for Internet commerce and an incentive for use of particular types of disclosures of terms. The section does not foreclose use of other procedures. Failure to use this section does not bear on whether a license is enforceable or whether the procedures used adequately establish an opportunity to review; this section acts as an incentive or safe harbor. When this section is not used, whether an opportunity to review has occurred should be viewed under the general standards set out in Section 112.

3. *Disclosure and Downloading.* The disclosure rules in this section are modeled after and adapt provisions of the federal Magnuson-Moss Warranty Act. They combine actual disclosure with availability of terms. It is sufficient that standard terms be available on request. Thus, terms might be made available by hyperlink on the particular site or through providing a potential licensee with an address (electronic or otherwise) from which the terms can be obtained. The terms to be made available are the standard terms of the license of the type involved. This section enables shopping for generic terms and thus focuses on standard terms of standard forms. Supplying those terms can meet the requirements for providing an opportunity to review if the provisions of this section are met.

The terms or a reference to them must be in a prominent place in the site or n close proximity to the information or instructions for obtaining it. The intended purpose of the close proximity standard is that the terms or the reference to them must be assure that it would be called to the attention of a reasonable person.

Given all other conditions being satisfied, this section is met if the licensor does not take affirmative steps to preclude printing or storage of the terms of the agreement. This does not require that the licensor adopt technologies that enable downloading or printing, although most present technology does so. It does require that there be nothing further done to preclude the possibility of one of those alternatives.

For example, a licensor that uses a technology which would otherwise enable copying the contract terms and modifies it specifically to preclude copying does not qualify under the provisions of this section. However, one method of compliance is sufficient: if the terms include sensitive information that is more easily distributed without authority if made available in electronic form, the licensor may preclude electronic copies. As long as it does not also preclude the ability to print a paper copy, this section is still satisfied. On the other hand, if the licensor links the person to another location under the control of a third party and at that location, affirmative steps are taken to prevent download, there is no compliance with this section.

[Subpart B. Electronic Contracts: Generally]

2-212. EFFICACY AND COMMERCIAL REASONABLENESS.

Uniform Law Source: Uniform Commercial Code: Sections 4A-201; 202 (1998 Official Text).

Definitional Cross References: Section 102: "Attribution procedure."

Official Comments:

1. *Scope of Section.* This section provides standards for determining if an attribution procedure is commercially reasonable.

2. *Decision of the Court.* Issues of whether a particular procedure is commercially reasonable or otherwise about its efficacy in the particular context are decisions made by the court under general standards of law as augmented in this Act. This Act, however, does not require a commercially reasonable attribution procedure or adopt any one type of procedure as reasonable or otherwise efficacious. Other law may do so, as may the agreement of the parties.

3. *Nature of an Attribution Procedure.* This Act does not dictate what constitutes an attribution procedure. Evolving technology and commercial practice make it impractical to predict future developments and unwise to preclude developments by a narrow statutory mandate. This Act relies primarily on the parties to select or use an appropriate procedure. In most cases, an attribution procedure is established by agreement or otherwise adopted by both parties. Assent is then a predicate for the creation of procedures that affect substantive rights. A procedure of which one party is not aware does not qualify. On the other hand, parties dealing for the first time may adopt a procedure for authentication or other purposes.

In some cases, statutes or regulations define a particular procedure as appropriate. These laws, such as digital signature statutes, establish by law a procedure that qualifies as an attribution procedure in this Act and that, under paragraph (1) are per se commercially reasonable within the scope of their coverage.

4. *Efficacy and Commercially Reasonableness.* The general idea of efficacy or commercial reasonableness is that the procedure be a reasonably effective method in the commercial context of identifying the party, detecting or preventing changes, or of achieving any other relevant purpose to which the procedure is addressed. This does not require proof that the procedure was state of the art, the most reasonable procedure, or an infallible procedure.

What is an effective or commercially reasonable procedure takes into account the choices of the parties and the cost relative to value of the transactions. How one gauges efficacy or commercial reasonableness depends on a variety of factors, including the agreement, the choices of the parties, technology, the types of transactions affected by the procedure, sophistication of the parties, volume of similar transactions engaged in, availability of feasible alternatives, cost and difficulty of utilizing alternative procedures, and procedures in general use for similar types of transactions.

The commercial reasonableness concept is similar to that in Uniform Commercial Code § 4A-202(c) (1998 Official Text), but that is not a requirement of this Act. The quality of an attribution procedure may reasonably be tailored to the particular transaction and the degree of risk involved. Additionally, if a procedure results from a fully negotiated agreement of the parties, it should receive deference in terms of its reasonableness applicable to their situation. This flows from the principle of assumed risk and that the parties' agreement should ordinarily be enforced. The same principle may apply if the two parties, aware of the risks of a particular procedure, nevertheless agree to use the procedure for a particular transaction. In effect, the parties then have concluded that it is effective or commercially reasonable in their context to accept the risks.

2-213. DETERMINING ATTRIBUTION.

Uniform Law Source: None.

Definitional Cross References.

Official Comments:

1. *Scope of Section.* This section deals with when an electronic authentication, message, record or performance is attributed to a particular person and with the consequences of failure to follow a procedure intended to detect errors. Attribution to a person means that the electronic event is treated in law as having come from that person.

2. *Nature of Attribution.* Subsection (a) clarifies that the party seeking to attribute the source of an electronic authentication, message, record or performance to a particular party bears the burden of doing so. "Burden of establishing" means "the burden of persuading the trier of fact that the existence of a fact (e.g., attribution) is more probable than its non-existence." In effect, a party (either the

licensor or the licensee) that desires to attribute an order or a shipment or license to a particular party bears the burden and the risk of being able to do so.

Attribution might involve reliance on agency law principles. In addition, the reference in subsection (a) to "other law" makes clear that the concept covers circumstances in which a person is bound by the act of another even though the acting person might not qualify as an agent. For example, if a woman gives her on-line account password to her brother so that he may use the account, his acts will be attributed to her even though he is not necessarily her agent. If he steals the password, she is not bound by his actions unless other law requires her to bear the consequences of his actions (e.g., under some state electronic signature statutes her contract with the issuer of the password can allocate liability to her, or a cause of action for negligence might exist in some circumstances).

3. *Nature of Proof.* Subsection (b) states the principle that the efficacy and other characteristics of an attribution procedure used by the parties are part of proof of attribution. The role of an attribution procedure in this context varies depending on the character of the procedure. Compliance with an attribution procedure that has a level of effectiveness suitable to that context or is commercially reasonable in the context may be treated by the court as carrying the burden of establishment referred to in subsection (a), subject to rebuttal by appropriate evidence, such as by a showing that the party in fact had no role in causing or permitting the electronic authentication, message, record or performance to occur.

For example, if the parties enter an agreement establishing an attribution procedure, the party seeking to rely on attribution to the other has the burden of establishing the agreement, the fact that it was followed in good faith and the procedure was commercially reasonable. Having done, the burden then passes to other party to establish that neither he nor a person with authority to act were responsible for the message, contract or performance. On the other hand, a procedure with very limited effectiveness and not reasonably suited to the context might have no effect at all in the evidentiary mix.

4. *Role of Agreement.* The section is subject to contrary agreement. An agreement here may have the initial effect of creating an attribution procedure which later plays a role in proving to whom the message is attributed. The agreement, however, may also deal with the effect of the procedure itself, and thereby trump the rules in this section. For example, an agreement between a law firm and West Publishing may provide that the law firm is responsible for the costs associated with any use for database access of the identification code issued to it.

The identification code is a form of attribution procedure. Absent agreement such as this, the effect of its use would be controlled under this section. In this case, however, the agreement itself specifies the effect of use of the code and that agreement controls. No special language is necessary to achieve this result: the agreement is enforceable under the same standards as any other term of an agreement. Thus, it must not be unconscionable or violate a fundamental public policy. See Section 105.

5. *Failure to Use.* Subsection (d) deals in a limited way with the effect of a failure by one party to conform to an attribution procedure. If the sender complies, but the recipient does not, the sender is not bound by an error that would have been detected through compliance by the recipient.

2-214. ELECTRONIC ERROR: CONSUMER DEFENSES.

Prior Uniform Law: None.

Definitional Cross References. Section 102: "Automated transaction"; "Consumer"; "Consumer contract"; "Copy"; "Delivery"; "Electronic"; "Electronic message"; "Good Faith"; "Information"; "Information processing system"; "Informational Rights"; "Notifies"; "Party"; "Person"; "Receive".

Official Comments:

1. *Scope of Section.* This section creates a statutory electronic error correction procedure for consumers that supplements common law concepts of mistake. The section does not displace common law of mistake or alter law concerning transactions that do not involve a consumer.

2. *Electronic Errors: Defined.* An electronic error in this section contemplates situations in which a consumer's human conduct causes an error in an electronic message. The rule here allows the consumer, by prompt action, to avoid the effect of the mistake. The defense does not apply if the electronic system with which the consumer is working itself reasonably provides a means to correct errors. Thus, a consumer's mistake in entering "11" as the quantity of copies desired may be an error, but does not come within this section if the automated ordering system with which the consumer interacts requires confirmation of the quantity and reasonably allows the consumer to correct any error before sending the order. The rule thus provides an incentive to establish error-correction procedures in automated contracting systems and provides protection to the consumer where such procedures are not present.

What is a reasonable procedure for correcting errors depends on the commercial context, including the extent to which the transaction entails immediate reactions. For example, in a transaction which occurs over a several day period, it may be reasonable to require a verification of a bid before it is placed, while in an on-line, real time auction, reconfirmation may not be possible. A reasonable procedure may entail no more than requiring two separate indications confirming that the bid should be entered. As elsewhere, the idea of a reasonable procedure here does not require use of the most effective procedure, or even the most reasonable, it requires merely that, all things taken into account, the procedure is commercially reasonable.

3. *Avoiding the Effect of Error.* If an electronic error occurs, a consumer can avoid responsibility for the unintended message if the consumer acts promptly. However, the message must not have been intended. Error avoidance is not a right to rescind a contract because of second thoughts.

The procedure created here establishes a rule that avoids the complexity and uncertainty of relying solely on common law principles about mistake in an automated world. In common law in many states, a party making a unilateral mistake is responsible for its consequences. This section creates a consumer protection that avoids such decisions.

To avoid the effects of an electronic error, the consumer must act promptly on learning of the error or of the other party's reliance. The consumer must notify the other party of the error and deliver back, at the consumer's cost, any copies of information received in the same condition as received. Return of copies is not required if the other party reasonably instructs the consumer to destroy the copies. However, the consumer must act promptly in a manner that returns the other party to the position that would have been true if the error had not occurred. *Compare* European Union *Distance Sales Directive* (no rescission right for consumer if software is not returned unopened).

This defense builds on equity principles that permit a party to avoid the consequences of its error if the error causes no detrimental effect to another party and does not give a benefit to the person making the mistake. The defense does not apply if the consumer used the information or otherwise received a benefit from it or the error. The defense is grounded in equity principles. Since there may be unavoidable detrimental effects on the party who received an erroneous message (e.g., costs of filling erroneous orders), courts must apply this rule with care. The basic assumption is that the defense works when there is no detrimental effect on the person who did not make the error, but that assumption is particularly suspect in cases where the nature of the information product makes for high costs to the provider or risk of fraud worked by the consumer.

Illustration 1: Consumer intends to order one game from Jones' web site. Consumer types 11. Jones electronically delivers 11 games or causes their shipment with an overnight courier. The next morning, Consumer notices the mistake. He immediately sends an e-mail to Jones describing the problem, offering to immediately return or destroy 10 copies at the Consumer's expense; he does not use the games. Under this section, there is no obligation for 11 copies but there is an obligation for 1. Jones bears any difference in costs for delivery of 11, vs. 1 game, and the inventory and return processing, while the consumer has the obligation to pay for the intended order and any cost of returning the extra products.

Illustration 2: Same facts as in Illustration 1, except that Consumer did intend to order 11 copies and merely changed his mind. The section does not apply.

Illustration 3: Same as in Illustration 1, but Jones' system asks Consumer to confirm an order of 11 copies. Consumer confirms. There was no "electronic error" since the procedure reasonably allowed for correction of the error. The conditions for application of this section are not met.

4. *Transactions Not With Consumers.* This section does not alter law in transactions that do not involve consumers or where consumers use electronic agents. The diversity of commercial transactions make a simple rule inappropriate because of the different patterns of risk and the greater ability of commercial parties to develop tailored solutions to the problem of errors. A court addressing electronic errors in these other contexts should apply general common law. The existence of the defense in this section for a consumer does not affect remedies under the general law of mistake.

2-215. ELECTRONIC MESSAGE

Definitional Cross References. Section 102: "Electronic"; "Electronic message"; "Information"; "Receive".

Official Comments:

1. *Scope of the Section.* This section deals with the timing of effectiveness of electronic messages and with the impact of an acknowledgment. It does not deal with questions of to whom the message is attributed or with liability for errors.

2. *Time of Receipt Rule.* Subsection (a) adopts a time of receipt rule; rejecting the mail box rule for electronic messages and resolving uncertainty about what common law rule would otherwise govern. This time-of-receipt rule reflects both the relatively instantaneous nature of electronic messaging and places the risk on the sending party if receipt does not occur. While the message is "effective" when received, being effective does not create a presumption that the message contains no errors or any presumption regarding from whom it was sent. The message is "effective" when received, not when read or reviewed by the recipient, just as written notice is received even if not read or acknowledged. This applies traditional common law theories to electronic commerce. In electronic transactions, automated systems can send and react to messages without human intervention. A rule that demands human assent would add an inefficient and error prone element or inappropriately cede control to one party.

3. *Effect of Acknowledgment.* Acknowledgment is not acceptance, although an acceptance can be a sufficient recognition also to be treated as an acknowledgment. Acknowledgment confirms receipt. Questions about the accuracy or the general content of the received message are not treated here. Of course, by agreement the parties can do so.

PART 3. TERRITORIAL APPLICABILITY AND GENERAL RULES

1-301. Territorial Applicability; Parties' Power to Choose Applicable Law.

(a) In this section:

(1) "Domestic transaction" means a transaction other than an international transaction.

(2) "International transaction" means a transaction that bears a reasonable relation to a country other than the United States.

(b) This section applies to a transaction to the extent that it is governed by another article of the [Uniform Commercial Code].

(c) Except as otherwise provided in this section:

(1) an agreement by parties to a domestic transaction that any or all of their rights and obligations are to be determined by the law of this State or of another State is effective, whether or not the transaction bears a relation to the State designated; and

(2) an agreement by parties to an international transaction that any or all of their rights and obligations are to be determined by the law of this State or of another State or country is effective, whether or not the transaction bears a relation to the State or country designated.

(d) In the absence of an agreement effective under subsection (c), and except as provided in subsections (e) and (g), the rights and obligations of the parties are determined by the law that would be selected by application of this State's conflict of laws principles.

(e) If one of the parties to a transaction is a consumer, the following rules apply:

(1) An agreement referred to in subsection (c) is not effective unless the transaction bears a reasonable relation to the State or country designated.

(2) Application of the law of the State or country determined pursuant to subsection (c) or (d) may not deprive the consumer of the protection of any rule of law governing a matter within the scope of this section, which both is protective of consumers and may not be varied by agreement: (A) of the State or country in which the consumer principally resides, unless subparagraph (B) applies; or (B) if the transaction is a sale of goods, of the State or country in which the consumer both makes the contract and takes delivery of those goods, if such State or country is not the State or country in which the consumer principally resides.

(f) An agreement otherwise effective under subsection (c) is not effective to the extent that application of the law of the State or country designated would be contrary to a fundamental policy of the State or country whose law would govern in the absence of agreement under subsection (d).

(g) To the extent that [the Uniform Commercial Code] governs a transaction, if one of the following provisions of [the Uniform Commercial Code] specifies the applicable law, that provision governs and a contrary agreement is effective only to the extent permitted by the law so specified: (1) Section 2-402; (2) Sections 2A-105 and 2A-

106; (3) Section 4-102; (4) Section 4A-507; (5) Section 5-116; [(6) Section 6-103;] (7) Section 8-110; (8) Sections 9-301 through 9-307.

PAROL OR EXTRINSIC EVIDENCE.

Uniform Law Source: Uniform Commercial Code: Sections 2A-202; 2-202 (1998 Official Text).

Definitional Cross References: Section 102: "Agreement"; "Course of dealing"; "Course of performance"; "Court"; "Party"; "Record"; "Term"; "Usage of Trade."

Official Comments:

1. *Scope of Section.* This section adopts the parol evidence rule from Uniform Commercial Code § 2-202 (1998 Official Text).

2. *Record as Final Expression.* The basic principle is that an agreed record of the contract is the best source for determining the agreement of the parties. This section excludes evidence of alleged terms or agreements that contradict the terms of a record intended as a final expression of the agreement on the terms covered or on terms on which confirmatory memoranda agree. The record need not be intended as the only statement of the agreement, but must be intended as final on the terms covered.

An alleged term or agreement is contradictory if its substance cannot reasonably co-exist with the substance of the terms of the record. Thus, an alleged term that calls for completion of a software project on July 1 contradicts a term of a record calling for completion on June 10. The two terms cannot reasonably co-exist as part of the same agreement. On the other hand, an alleged term that specifies the processing capacity of the software does not contradict the terms of a record that does not make reference to that issue. Of course, the fact that the term does not contradict the record means only that evidence of it can be admitted. It does not indicate whether the alleged term was actually agreed by the parties.

This rule does not preclude proof of subsequent modifications of the agreement. What is excluded is evidence of prior or contemporaneous agreements that are not in the record. Subsequent modification may be shown by appropriate evidence. Of course, terms of the original record may restrict what subsequent modification may be proven or effective, such as by requiring that all modifications be in an authenticated record. Section 303.

3. *Practical Construction.* Paragraph (1), however, makes admissible evidence of course of dealing, usage of trade, and course of performance to explain or supplement the terms of any record stating the agreement of the parties. This does not depend on a prior determination that the language of the record is ambiguous. Instead, these sources of interpretation are allowed in order to reach an accurate understanding of the parties' intent as to their agreement. Records of an agreement are to be read on the assumption that the course of prior dealings between the parties and the usage of trade were taken for granted when the record was drafted. Unless carefully negated by the record, they are an element of the meaning of the words used. Similarly, the course of actual performance by the parties may be the best indication of what the parties intended the record to mean.

4. *Consistent Additional Terms.* Under paragraph (2), consistent additional terms not reduced to a record may be proved unless the court finds that the record was intended by both parties as a complete and exclusive statement of all the terms. This rejects the view that any record that is final on some terms should be, without more, treated as final on all terms of the agreement. On the other hand, if alleged additional terms are such that given the circumstances of the transaction, if agreed upon, they would certainly have been included in the record of the agreement, evidence about the alleged terms must be kept from the trier of fact under this standard.

In many cases, evidence of the parties' intent about the exclusive nature of the record of their agreement will be provided in the record itself. Particularly in commercial agreements, it is common to include a merger clause stating that the record is intended by both parties as a complete and exclusive expression of the terms of the contract. Under the UNIDROIT Principles of International Commercial Law, merger clauses are conclusive on the issue of intent. As a practical matter, a merger clause in a negotiated commercial contract creates a strong, nearly conclusive presumption that both parties intended the record to be the exclusive statement of their agreement.

The merger clause does not preclude a court from using course of dealing, usage of trade or course of performance to understand the meaning of contract terms, but does place a difficult burden on the party seeking to establish that additional terms exist. Even in a commercial case, however, the presumption can be shown to be inappropriate if the record itself refers to terms contained in or documented by material extraneous to the purportedly exclusive record. Of course, records that contain a merger clause but refer to other documents may still reflect an intent to be exclusive if the statement of what represents the aggregate exclusive statement of agreement includes all documents intended to be aggregated, including the referenced external documents.

1-302. Variation by Agreement.

(a) Except as otherwise provided in subsection (b) or elsewhere in [the Uniform Commercial Code], the effect of provisions of [the Uniform Commercial Code] may be varied by agreement.

(b) The obligations of good faith, diligence, reasonableness, and care prescribed by [the Uniform Commercial Code] may not be disclaimed by agreement. The parties, by agreement, may determine the standards by which the performance of those obligations is to be measured if those standards are not manifestly unreasonable. Whenever [the Uniform Commercial Code] requires an action to be taken within a reasonable time, a time that is not manifestly unreasonable may be fixed by agreement.

(c) The presence in certain provisions of [the Uniform Commercial Code] of the phrase "unless otherwise agreed", or words of similar import, does not imply that the effect of other provisions may not be varied by agreement under this section.

PRACTICAL CONSTRUCTION.

Uniform Law Source: Uniform Commercial Code: Section 2A-207; Section 2-208; Section 1-205 (1998 Official Text). Revised.

Definitional Cross References. Section 102: "Agreement"; "Contract"; "Course of dealing"; "Course of performance"; "Knowledge"; "Usage of trade". Uniform Commercial Code: "Party": Section 1-201; "Term": Section 1-201.

Official Comments:

1. *Scope of the Section.* This section is based on Uniform Commercial Code §§ 1-205; 2-208 (1998 Official Text), and provides that in interpreting an agreement a court should refer to relevant indicia of context in which the parties formed and performed their agreement. **2.** *Construction based on Performance.* This section adopts the premise that the parties themselves know best what they have meant by the words of their agreement and that their actions under that agreement are an important indication of that meaning. Behavior, of course, is subordinate to express contract terms. However, beyond that, course of performance provides an important component of the factors that determine the meaning of the "agreement" of the parties. Course of performance (as well as usage of trade and course of dealing) are relevant to determine the meaning and content of the agreement.

3. *Nature of Course of Performance.* A course of performance requires repeated performance by one party known to the other, an opportunity of the other to object, and a pattern of acceptance or acquiescence by that other party. Since it provides a basis for understanding the agreement of the parties, the events creating it must have mutual elements. Unilateral conduct unknown to the other party, such as by making uses of information beyond the terms of a license, cannot establish a course of performance. Similarly, a single occasion of conduct does not fall within this concept, although a single event may affect the parties' rights in other respects.

4. *Relationship to Waiver.* A particular pattern of action may provide insight into the meaning of the agreement or represent a waiver of a term of an agreement. The preference in this Act is in favor of a "waiver" (if the elements of waiver are present) whenever this construction is reasonable because this preserves the flexible character of commercial contracts and prevents surprise or other hardship. A waiver by conduct may be retracted as to future conduct. An interpretation of the agreement measures the meaning of a contract binding on both parties and which cannot be retracted by one.

5. *Order of Interpretation.* Subsection (a) sets out the order of preference in interpreting an agreement among express terms, course of performance, course of dealing, and usage of trade. Express terms always govern. Course of performance and course of dealing are the next preferred, respectively, because each relates to the behavior of the particular parties.

6. *Place of Performance.* Subsection (b) provides guidance indicating that, as applied to a performance, any applicable usage of trade is determined in reference to that place. Of course, however, the alleged usage of trade must meet the definition of that term in reference to its being known to all parties to the contract.

1-303. Course of Performance, Course of Dealing, and Usage of Trade.

(a) A "course of performance" is a sequence of conduct between the parties to a particular transaction that exists if: (1) the agreement of the parties with respect to the transaction involves repeated occasions for performance by a party; and (2) the other party, with knowledge of the nature of the performance and opportunity for objection to it, accepts the performance or acquiesces in it without objection.

(b) A "course of dealing" is a sequence of conduct concerning previous transactions between the parties to a particular transaction that is fairly to be regarded as establishing a common basis of understanding for interpreting their expressions and other conduct.

(c) A "usage of trade" is any practice or method of dealing having such regularity of observance in a place, vocation, or trade as to justify an expectation that it will be observed with respect to the transaction in question. The existence and scope of such a usage must be proved as facts. If it is established that such a usage is embodied in a trade code or similar record, the interpretation of the record is a question of law.

(d) A course of performance or course of dealing between the parties or usage of trade in the vocation or trade in which they are engaged or of which they are or should be aware is relevant in ascertaining the meaning of the parties' agreement, may give particular meaning to specific terms of the agreement, and may supplement or qualify the terms of the agreement. A usage of trade applicable in the place in which part of the performance under the agreement is to occur may be so utilized as to that part of the performance.

(e) Except as otherwise provided in subsection (f), the express terms of an agreement and any applicable course of performance, course of dealing, or usage of trade must be construed whenever reasonable as consistent with each other. If such a construction is unreasonable: (1) express terms prevail over course of performance, course of dealing, and usage of trade; (2) course of performance prevails over course of dealing and usage of trade; and (3) course of dealing prevails over usage of trade.

(f) Subject to Section 2-209, a course of performance is relevant to show a waiver or modification of any term inconsistent with the course of performance.

(g) Evidence of a relevant usage of trade offered by one party is not admissible unless that party has given the other party notice that the court finds sufficient to prevent unfair surprise to the other party.

MODIFICATION AND RESCISSION.

Uniform Law Source: Uniform Commercial Code: Sections 2A-208; 2-209 (1998 Official Text).

Definitional Cross References. Section 102: "Agreement"; "Authenticate"; "Consumer"; "Contract"; "Merchant"; "Record"; "Standard form"; "Term".

Official Comments:

1. *Scope of the Section.* This section deals with modifications of contracts and agreed limits on the ability to modify. It is subject to Section 304 on changes made pursuant to contract terms allowing changes. The section generally follows Uniform Commercial Code § 2-209 (1998 Official Text), but makes various changes and moves provisions on the relationship between attempted modification and waiver to Section 702.

2. *Role of Contract Modifications.* Subsection (a)makes modifications of contracts effective without regard to issues about lack of consideration. The modification must be in an agreement, however, indicating assent by both parties. As in Uniform Commercial Code 2-209 (1998 Official Text), there is no requirement that a modification be proposed in good faith.

A court should not be asked to accept or invalidate an agreed modification based on its view of the fairness of the commercial motivations of the party proposing the modification or whether the agreement is fair. However, there must be agreement. This protects against over-reaching and extortion-like demands in cases of abuse, allowing courts to apply ordinary concepts related to fraud or duress in appropriate cases.

3. *Contract Terms Prohibiting Oral Modification.* Subsection (b) recognizes the general enforceability of a contract term that bars modification or rescission of an agreement except in an authenticated record. This type of contract term has great importance in commercial relationships especially when the relationship involves on-going performances.

Contractually preventing modifications not contained in an authenticated record plays an important role in preventing false allegations of oral modifications, difficulties of establishing terms, and avoiding circumvention of express agreements through later terms that do not require authorized authentication by the recipient. For example, a "no modification without authentication" term should prevent modification of a basic agreement through a later provided mass-market license that is not authenticated by the party receiving the license. *Morgan Laboratories, Inc. v. Micro Data Base Systems, Inc.,* 41 U.S.P.Q.2d 1850 (N.D. Cal. 1997). Such terms permit parties to make their own statute of frauds and to control their risk.

Subsection (b) adopts the policy stated in the Uniform Commercial Code Article 2 (1998 Official Text) that in consumer transactions such terms are enforceable only if the consumer assents specifically to

the term. Article 2 requires a consumer to sign the term. This Act substitutes the requirement of manifesting assent to the term to better fit modern electronic commerce. The limitation in subsection (b) does not apply to a transaction that is not a consumer transaction.

4. *Statute of Frauds.* Under subsection (c), the contract as allegedly modified and the modification itself must satisfy the statute of frauds and Section 307(g) to be enforceable. This prevents unfounded claims of oral modification that alter the contract in a way that derogates Section 201(a) requirements or that alters the requirements of Section 307(g).

The alleged modification cannot, without an authenticated record, transform a $6,000 two year license of computer information into a perpetual license, nor can it alter the subject matter of a film clip license for a multi-media product to include an entirely different clip outside the subject matter in the original record. On the other hand, a modification that changes the delivery date without altering the term or subject matter, need not be in an authenticated record if the original agreement was in such a record. In that case, the original record suffices under Section 201 and 307 as to the modified contract.

Partial performance under the original agreement validates the original agreement, but if the modification alters subject matter, duration, scope, price or other significant terms, that partial performance does not validate the modified contract. If the contract as modified does not satisfy the statute of frauds, the original agreement that did satisfy the Section 201 constitutes the contract of the parties.

The modifications must, of course, also satisfy any other applicable rules limiting the effectiveness of agreed terms. Thus, disclaimers of warranties must conform to the disclaimer rules and modifications of scope must comply with Section 307.

5. *Waiver.* A party whose conduct is inconsistent with a contract term may place itself in a position from which it may no longer assert that term until it gives notice to the other party that it intends to do so. That principle of waiver is discussed in Section 702 and applies to contract term requiring a signed record for valid modification. But waiver occurs only if the conduct induced the other party reasonably and in good faith to rely and that reliance precludes changing the position as to past conduct or as to future conduct unless steps are taken to cut off reasonable reliance on the waiver as to the future. *See Autotrol Corp. v. Continental Water Systems,* 918 F.2d 689, 692 (7th Cir. 1990); *Wisconsin Knife Works v. National Metal Crafters,* 781 F.2d 1280 (7th Cir. 1986).

Reasonableness of such behavior, of course, must be considered in light of the circumstances, including the fact of a no-oral waiver clause. Courts should be slow to find waiver of anti-waiver provisions in general and "no-oral modification" clauses in particular. *See* 1 *White & Summers, Uniform Commercial Code* 1-6, pp. 41-42 (4th Ed. 1995). With "no-oral modification" clauses, it is more likely that the conduct constitutes a waiver of the substantive term for a particular performance, rather than of the "no-oral-modification" clause itself which would open up the entire contract based on behavior affecting one part. The better interpretation is consistent with Section 302, preferring a waiver analysis over a modification analysis in close cases.

1-304. Obligation of Good Faith.

Every contract or duty within [the Uniform Commercial Code] imposes an obligation of good faith in its performance and enforcement.

CONTINUING CONTRACTUAL TERMS.

Definitional Cross References. Section 102: "Agreement"; "Contract"; "Good faith"; "Mass-market transaction"; "Notice"; "Notify"; "Party"; "Term"; "Termination".

Official Comments:

1. *Scope of the Section.* This section deals with contracts involving on-going performances by one or both parties. It clarifies enforceability of agreed methods allowing changes in terms in on-going performance.

2. *Continuing Terms.* Subsection (a) states two important principles. The first is that initial contract terms cover all performance under the contract. This rule applies whenever the agreement includes subsequent performances. Thus, a warranty disclaimer in a contract for on-going use of a website applies to all subsequent performances and uses pursuant to that contract. On the other hand, if separate access to a system involve separate agreements for access or for information, the terms of the first agreement do not cover the second.

Subsection (a) recognizes that contract terms can be changed pursuant to procedures established by the contract. The procedures might rely on third party actions (e.g., changes in regulations), an external private standard (e.g., a price index), or changes made by a party pursuant to a contractual procedure. The ability to change terms is subject to general common law principles about a contract

requiring mutuality of obligation. The affirmative principle is that, in a commercial agreement, if parties agree to a procedure by which terms can be altered, they are bound by that agreement and changes made pursuant to that agreed procedure are binding.

3. *Changes in Terms.* Subsection (b) creates incentives to provide more protections to the party that is not changing the contract. When parties contract to make changes pursuant to a specified procedure, if the provisions of this subsection are met the changes are effective and this section excludes any argument that a contract establishing a procedure like that outlined here fails for lack of mutuality. If the terms of subsection (b) are not met, however, neither the contract nor the changes are made unenforceable by this Act, but the parties do not receive the benefit of the certainty provided by complying with the subsection.

The subsection states some conditions under which an agreed procedure used by the parties is effective under this Act. It addresses important practices in online and other contracts, such as outsourcing agreements. This section does not alter prior agreements or consent orders dealing with particular parties which may limit, or expand, the ability to make changes in terms of an on-going contract. This subsection deals with agreements that permit changes in terms, but does not create a unilateral right to change terms when the parties have not previously agreed to an applicable procedure.

Long term on-line contracts frequently involve changes in terms of service. Separate notice or negotiation of each change is not feasible or desired by the parties, especially where the change affects a large number of users. Commercial practice must accommodate efficient methods of making changes by providing in the original agreement for a right of one party to alter terms during the contract period. Subsection (b) authorizes two contractual procedures that create effective changes. This does not preclude other methods or imply that other contractual arrangements are unenforceable.

Contract terms allowing procedures for changes are the converse of contractual provisions restricting modification other than in an authenticated record. They are analogous to cases in which the agreement leaves the particulars of performance to be specified by one party. See U.C.C. Article 2 and Section 305. The need for and enforceability of such changes is recognized in other law.

It is especially important in electronic commerce to recognize this right because this area of commerce is subject to evolving rules and circumstances that are not predictable, but may require adjustment of performance, risk allocation, and other characteristics of the relationship. For example, in an out-sourcing contract, a provider may make significant investments relying on a five year contractual term, but the circumstances may require reservation of the right to change terms as technology changes. In such contracts, notice is appropriate, but it would not be appropriate to require a blanket rule that the change yield a right to withdraw from the contract. The requirement that the change be made in good faith prevents the party making the change from taking undue advantage.

a. Relationship to Other Rules. The procedures described in subsection (b) must be pursuant to a contract term authorizing a procedure for changes. The terms of an on-going contract may, of course, be effectively altered in other ways. For example, the parties may agree to modify the contract. Similarly, general principles of waiver affect the terms of the agreement.

b. Contracts. Subsection (b)(1) provides that a change becomes part of the contract if it meets the following conditions:

- it is proposed in good faith, which includes meeting standards of commercial fair dealing;
- it is proposed pursuant to an agreed procedure;
- the authorized procedure reasonably notifies the other party of the change.

Subsection (b)(1) requires that the procedure reasonably notify the other party of the change. What constitutes reasonable notification depends on the circumstances. This Act preserves substantive consumer statutes (Section 105); thus if a consumer statute specifies a method for notice of changes, this Act does not displace that specification. Under this Act, posting at an agreed location designated for that purpose would ordinarily suffice; there is no requirement that individual changes be separately singled out, although such may be appropriate for especially material changes such as a change in price. Often, reasonable notification requires action before the change is effective, but in some emergency situations, notice that coincides with the change or follows it is sufficient (e.g., blocking access to a virus infected site, or a change in access codes to prevent third party intrusions). A procedure that calls for posting changes in an accessible location of which the other party is aware will ordinarily satisfy this requirement. The overall context of the contract must be considered.

Subsection (c) clarifies that the standards for notification can be established by agreement, so long as the terms are not manifestly unreasonable. Ordinarily, in a negotiated commercial agreement, standards set by agreement are not to be considered manifestly unreasonable.

c. Mass-Market Transactions. In mass-market transactions, subsection (b)(2) authorizes an agreed procedure only if standards of good faith and reasonable notification apply and the consumer has a right in good faith to withdraw from the contract with respect to future performances. This additional element is not appropriate as a rule for commercial contracts. The termination right must be exercised in good faith and for a material change adverse to the licensee. Price changes are material in all cases. Other changes may be, such as a significant change in the agreed hours during which the on-line system is available. Of course, a reduction in price or other beneficial change does not require a right to terminate.

Withdrawal must be without penalty, but the licensee must, of course, perform the contract to the date of withdrawal (e.g., pay all sums due). In many mass-market licenses that entail continuing performance, the contract itself may be subject to termination at will. Subsection (b) does not alter that rule.

4. *Changes in Content.* This section deals with changes in contract terms and does not cover changes in content available under an access contract. In an access contract, the access rights to materials as changed by the licensor over time. Unless an express contract term provides otherwise, a decision to add, modify, or delete a database or a part of a database does not modify the contract, but merely constitutes the performance of the licensor and is not within this subsection.

1-305. Remedies to be Liberally Administered.

(a) The remedies provided by [the Uniform Commercial Code] must be liberally administered to the end that the aggrieved party may be put in as good a position as if the other party had fully performed but neither consequential or special damages nor penal damages may be had except as specifically provided in [the Uniform Commercial Code] or by other rule of law.

(b) Any right or obligation declared by [the Uniform Commercial Code] is enforceable by action unless the provision declaring it specifies a different and limited effect.

TERMS TO BE SPECIFIED.

Uniform Law Source: Uniform Commercial Code Section 2-311 (1998 Official Text).

Definitional Cross References. Section 102: "Agreement"; "Contract"; "Good faith"; "Seasonable"; "Party".

Official Comments:

1. *Scope of Section.* This section follows Uniform Commercial Code § 2-311 (1998 Official Text). It deals with contracts in which one party reserves or is granted the right to specify terms of performance.

2. *Enforceability.* This section is an express recognition of one form of layered contracting in which terms are established after the initial agreement, rather than at the time of initial agreement. If the initial agreement is sufficiently definite to form a contract, this section allows parties to leave particulars of performance to be filled in by a party without running the risk of having the contract invalidated for indefiniteness. The party empowered to specify the missing details is required to exercise good faith and to act in accordance with commercial standards so that there is no surprise; the range of permissible specifications is limited by what is commercially reasonable.

The agreement which permits one party so to specify may be found in a course of dealing, usage of trade, implication from the circumstances or in explicit language used by the parties. Thus, acquisition of information through a telephone order where there is reason to know that terms to be provided by the other party will indicate details of the contractual arrangement may fall within this section. Supplied under this section, the details supplied are bounded by trade use and commercial expectations (as well as by the terms actually agreed by the parties).

2. *Conditions.* Paragraph (2) applies when specification by one party is necessary to or materially affects the other party's performance, but is not seasonably made. The section excuses the other party's resulting delay in performance. The hampered party may perform in any reasonable manner, suspend its performance, or treat the other person's failure as a breach of contract. These rights are in addition to all other remedies available under the contract or this Act. This includes the right to demand reasonable assurances of performance because the delay caused insecurity. The request for assurances may also be premised on the obligation of good faith established in this section, which obligation may imply the need for a reasonable indication of the time and manner of performance for which the other party is to hold itself ready.

1-306. Waiver or Renunciation of Claim or Right After Breach.

A claim or right arising out of an alleged breach may be discharged in whole or in part without consideration by agreement of the aggrieved party in an authenticated record.

PERFORMANCE UNDER OPEN TERMS.

Definitional Cross References. Section 102: "Agreement"; "Party".

Official Comments:

1. *Scope of Section.* This section provides a general interpretation rule for contract issues not covered by the agreement or other sections of this Act. It follows the approach in Article 2 of the Uniform Commercial Code (1998 Official Text).

2. *Commercial Context.* Construction of contracts must be based on the commercial context. If the agreement or this Act does not provide content for a term left open by the parties, a court must adopt a standard that is reasonable in light of the commercial circumstances. This default rule applies only if there is no contract term. Agreement may be found in express language or in usage of trade or course of dealing.

What is reasonable in such cases depends on the nature, purpose and circumstances of the action to be taken or avoided and on the entire commercial context of the agreement. If the reasonableness standard applies, a party is not required to fix, at peril of breach, a time or performance that is in fact reasonable in the unforeseeable judgment of a later trier of fact. In such cases, under general requirements of good faith, effective communication by one party to the other of a proposed time limit or other interpretation of a reasonable performance calls for a response so that a failure to reply in a timely manner creates an inference of acquiescence to the proposal. If the recipient of the proposal objects or if no proposal is made, a demand for assurance on the ground of insecurity may be made pending further negotiation. Only if a party insists on undue delay or unreasonable performance or rejects the other party's commercially reasonable proposal does a question of breach arise.

3. *Lack of Contract.* This section does not apply if the parties do not intend an agreement. If a term is left open because there was no agreement on the term and the intent of the parties precludes a contract unless or until that agreement occurs, see Section 202(e).

1-307. Prima Facie Evidence by Third-Party Documents.

A document in due form purporting to be a bill of lading, policy or certificate of insurance, official weigher's or inspector's certificate, consular invoice, or any other document authorized or required by the contract to be issued by a third party is prima facie evidence of its own authenticity and genuineness and of the facts stated in the document by the third party.

INTERPRETATION AND REQUIREMENTS FOR GRANT.

Definitional Cross References. Section 102: "Agreement"; "Authenticate"; "Contract"; "Copy"; "Delivery"; "Information"; "Informational rights"; "License"; "Licensee"; "Licensor"; "Party"; "Person"; "Receive"; "Record"; "Scope"; "Term".

Official Comments:

1. *Scope of Section.* This section deals with issues of interpretation and enforcement of a license, establishing the basic premise that a license should be interpreted in a commercially reasonable manner and providing specific interpretation rules that reflect commercial practice.

2. *License Grant.* Subsection (a) provides a state law rule that a license gives the contractual rights expressly granted and, in appropriate cases, limited implied rights to the extent necessary to use the expressly granted rights in the information. This implied license applies only to rights within the control of the licensor at the time of the license. For example, a license to use a photograph in a digital product implies a right to transform that photograph into digital form assuming this right was within the licensor's control at the time.

A license of software to create visual presentations for public speaking implies a right to publicly display images from the software in such presentations because that right is necessary to the expressly granted right. The implied rights, however, pertain only to rights, information and material provided to the licensee. They do not require that the licensor transfer additional materials (such as source code), unless that transfer was agreed by the parties. Additionally, the implied rights must be necessary to the express grant and do not include rights merely because they are desired, common or even helpful, unless necessary to the expressly granted uses. Express terms creating greater rights or lesser rights, of course, over-ride any implied rights

Subsection (a) expresses a state contract law interpretive rule. Some cases hold that federal policy requires interpretation of the scope of a license against the licensee and in a manner that withholds

any use not expressly granted. *SOS, Inc. v. Payday, Inc.,* 886 F.2d 1084 (9th Cir. 1989). The better view is that applied in cases such as *Bourne v. Walt Disney Co.,* 68 F.3d 621 (2d Cir. 1995), which treat interpretation issues as ordinary commercial contract questions. Of course, to the extent a mandatory federal policy precludes different state law on this issue, that policy over-rides the standard in subsection (a).

3. *Exceeding the Grant.* Subsection (b) resolves the interpretation of a license that gives the licensee a right "to do X" when the licensee does an act that exceeds or differs from "X.". There are two rules. First, when the contract limit term is express, actions different from the expressly limited grant are a breach of contract. This refers to the grant as interpreted, including consideration of course of dealing, usage of trade and subsection (a). Second, when the license is less explicit, subsection (b) provides that there is an implied limitation that the licensee will not use the information other than as described in the contract and subsection (a). Uses outside these terms are a breach of contract.

This rejects case law that requires express limiting language for this result, such as a license that allows the licensee "*only* to do X". If the word "only" or its equivalent does not appear, some patent cases hold that uses not covered by the grant infringe the patent, but may not breach the license. Independent of infringement issues, as a matter of contract law, a rule that hinges on the use or failure to use the word "only" provides a trap that is avoided in subsection (b) by adopting the ordinary commercial understanding that an affirmative grant implicitly excludes uses that exceed or are not otherwise within the grant.

The implied limitation, however, does not yield a breach of contract if the use would have been permitted by law in the absence of the implied limitation. Thus, scholarly use of a quotation from licensed material not subject to trade secrecy restraints, if a fair use under federal law, would not conflict with the implied limitation. However, even if a license does not use the word "only" and gives a right to use software at a designated location, a licensee that does something that is not included in that grant, such as making multiple copies for sale, infringes the copyright and breaches the contract. A license for use in Peoria implies the lack of a right to do so in Detroit, just as a contractual right to use information for 100 users implies a lack of a right to use it for 101 or more.

4. *Number of Users.* A license can specify the number of permitted users by stating a specific number or by referring to all users at a particular location. In the absence of agreed terms, under subsection (c), the contract authorizes a number that is reasonable in light of the informational rights and commercial circumstances involved. In some cases, especially a mass market license, a single user limit would be assumed. In other contexts, network use concepts are more appropriate. Given the diversity of the marketplace, no single presumed number of users or uses would fairly meet all circumstances.

Of course, as with all default rules in this Act, this provision is subject to contrary agreement, which agreement may be found as well in express terms as in course of dealing, usage of trade and course of performance. Thus, if the parties agree that all persons at a designated site may be simultaneous users, that agreement controls and the default rule is not applicable.

5. *Improvements and Design Material.* Under subsection (d) and (e), unless the contract clearly indicates otherwise, neither party has a right to receive subsequent modifications or improvements made by the other, or a right of access to design and confidential material. Arrangements for such material as modifications, improvements, source code or designs entail separate relationships handled by express contract terms. In the absence of express terms, the contract gives no rights to such material to either party. This contract law principle does not, of course, supplant intellectual property rules on derivative works. Section 105(a).

6. *Grant Clauses.* Subsection (f) states that ordinary commercial contract principles apply to interpreting a license grant. As a state law rule, of course, it is subject to contrary federal policy which, some courts hold, requires interpretation of a grant in favor of the licensor.

Subsections (f)(1) and (f)(2) provide guidance on important license terms. Subsection (f)(1) adopts the majority rule on when a grant covers future technologies and rights. Use of statutory or other language that implies a broad scope without qualification should be sufficient to cover any and all rights as well as present and future media (such as print, television, on-line and other modes of distribution). This is subject to the other default rules in this Act, including for example, the premise that the licensee does not receive any rights in enhancements made by the licensor unless the contract expressly so provides. The interpretation rule does not encourage use of such broad grants, but merely provides guidance regarding what language achieves the indicated result when it is agreed by the parties.

Subsection (f)(2) resolves a conflict in case law. It clarifies that an exclusive license that does not otherwise deal with the issue, conveys exclusive rights that include restrictions on rights of the licensor. Thus, the licensor may not license or use the information within the scope of the exclusive

license, and affirms that it has not granted any other subsisting license covering the same scope and will not grant any future license covering the same scope that takes effect during the duration of the original exclusive license.

1-308. Performance or Acceptance Under Reservation of Rights.

(a) A party that with explicit reservation of rights performs or promises performance or assents to performance in a manner demanded or offered by the other party does not thereby prejudice the rights reserved. Such words as "without prejudice," "under protest," or the like are sufficient.

(b) Subsection (a) does not apply to an accord and satisfaction.

DURATION OF CONTRACT.

Uniform Law Source: Uniform Commercial Code Section 2-309(2) (1998 Official Text).

Definitional Cross References. Section 102: "Agreement"; "Cancellation"; "Computer program"; Contract"; "Contract Fee"; "Contractual use term"; "Copy"; "Delivery"; "Information"; "Informational rights"; "License"; "Licensee"; "Notice"; "Party"; "Seasonable"; "Termination".

Official Comments:

1. *Scope of Section.* This section deals with contracts in which the agreement does not indicate its duration. The section follows common law and Uniform Commercial Code Article 2 (1998 Official Text) but sets out two rules that expand licensee rights. This section does not deal with contracts that specify their duration, such as a license for a stated perpetual term or number of years. The section applies only if there is a contract, but the contract does not state its duration. In some cases, failure to agree on duration indicates that no contract exists.

2. *Basic Rule.* Subsection (1) follows the common law of most states and Uniform Commercial Code Article 2 (1998 Official Text) by adopting a rule of commercial reasonableness to define the duration of contracts of indefinite duration. What time is reasonable for any given arrangement is defined by the commercial circumstances. See Section 114. A contract running for a commercially reasonable time can continue indefinitely since, if the parties continue to perform, the contract will not terminate until notice is given. The basic policy, however, is that a person making an indefinite commitment can be required to perform over a time that is reasonable, but cannot be placed in a position of perpetual servitude.

The commercial circumstances that determine what is a reasonable time include licenses or third-party rights which place limitations on the licensor of the information. The licensor should not be presumed to have given a license that exceeds the duration of its own rights (such as the licenses by which it is bound to third parties). More generally, the reasonable duration should reflect the rights involved. Various federal policy considerations affect duration. A patent license that does not state its term can reasonably be presumed to extend for no longer than the life of the patent. A similar rule may exist for an indefinite copyright license. For a copyright license of an indefinite term, however, duration may be subject to preemptive copyright law rules. *Rano v. Sipa Press, Inc.*, 987 F2d 580 (9th Cir. 1993).

3. *Termination at Will.* An indefinite duration contract can be terminated at will by either party, except as provided in subsection (2). This follows common law (except for the expansion of licensee protections). Under this rule, for example, a contract that grants a license and promises support services for an indefinite period can be terminated at will as to the support services. Treatment of the licensed rights is handled differently under subsection (2).

At will termination enables a non-judicial method of ending the contract. Parties to a contract are not required, in giving notice of termination, to fix, at peril of breach, a time which is in fact reasonable in the unforeseeable judgment of a later trier of fact. The right to terminate at will enables closure of the relationship on appropriate notice; whether or not this occurs after a reasonable time has passed for the entire contract is not relevant or a source of liability risk. If, on the other hand, a party's communication sets a proposed time limit for termination of the contract, that proposal calls for a response and failure to reply will infer acquiescence. If objection is made on grounds that the proposed time is unreasonable or if the demand is merely for information, demand for assurance on the ground of insecurity may be made under this Act pending further negotiation.

4. *Termination.* Termination discharges obligations that are executory on both sides, except as indicated in Section 616 and the agreement. It does not affect rights vested based on prior performance. Thus, if a contract grants a permanent right to use software, but the agreement also creates an indefinite duration obligation to support the software, termination does not affect the licensed rights (vested because of prior performance), but ends the obligation to provide support in the future.

5. *Contracts for Definite Term.* This section does not apply if the agreement provides for a specific duration. Agreement to a definite duration may be found in express language, usage of trade or course of dealing. A distinction may be made between the duration of licensed rights and the term of obligations requiring on-going, affirmative performance. A license for "the life of the edition", "for so long as the work remains in print" or"perpetually," defines a duration just as does a contract that specifies a one year duration. On the other hand, commitments to "lifetime" service or support are indefinite in duration. In the case of a license duration, what is being defined is the period over which use extends and there is no risk of servitude that justifies ignoring the literal terms of the grant. On the other hand, a commitment for support or new editions raises the servitude issue and the underlying problem to which the "reasonable term" rule applies

6. *Presumed Perpetual Licenses.* Subsection (2) rejects the common law and Article 2 in two contexts by providing that the duration of an indefinite license, other than for source code, is perpetual as to the licensed rights and use restrictions, subject to cancellation for breach or contrary agreement. The exception for source code acknowledges commercial practice that denies long term rights in confidential material in the absence of express agreement.

A perpetual term is the default rule if a license transfers ownership of a copy or delivers a copy of software for a single fee, the total amount of which is determined at or before delivery. This does not contemplate royalty or other variable fees whose total dollar amount cannot be determined at the outset. This rule seeks to identify situations in the mass market and other similar settings where the transaction commercially may convey implicit long term rights to the licensee. The default rule is over-ridden in cases where the circumstances suggest that, despite a single fee or similar terms, there is no agreement for perpetual rights.

The second situation deals with cases where the licensed information is incorporated into a product for distribution to third parties, such as an art clip licensed for use in a digital multimedia encyclopedia. This recognizes the reliance interests that develop in such case and which would be disrupted by an at-will termination right.

1-309. Option to Accelerate at Will.

A term providing that one party or that party's successor in interest may accelerate payment or performance or require collateral or additional collateral "at will" or when the party "deems itself insecure," or words of similar import, means that the party has power to do so only if that party in good faith believes that the prospect of payment or performance is impaired. The burden of establishing lack of good faith is on the party against which the power has been exercised.

AGREEMENT FOR PERFORMANCE TO PARTY'S SATISFACTION.

Uniform Law Source: Restatement 228. Revised.

Definitional Cross References. Section 102: "Agreement"; "Contract"; "Informational content"; "Party"; "Person"; "Term".

Official Comments:

1. *Scope of Section.* This section deals only with cases where the agreement provides that the acceptability of a required performance is to be based on the satisfaction of the party receiving the performance.

2. *Basic Rule.* Subsection (a) follows the *Restatement (Second) of Contracts* § 228. Contract terms that define acceptability in terms of "to the satisfaction" of another party ordinarily should be interpreted as requiring measurement under an objective or reasonable person standard. The issue is whether the tender would be acceptable to a reasonable person. This rule precludes arbitrary demands. It is supplemented in this Act by the general obligation of good faith that applies to all contracts.

3. *Subjective Standard.* There are cases where a subjective standard of satisfaction is appropriate. Subsection (b) indicates when such a subjective standard applies. The most obvious is when the contract specifically so states. Subsection (b)(1) provides language that indicates a subjective satisfaction standard.

Also, subsection (b)(2) presumes a subjective standard if the contract involves informational content evaluated on aesthetics, appeal or the like to the satisfaction of the party. As the subsection makes clear, this is referring to cases where the evaluation on these factors is to reflect subjective criteria and judgment. A reasonable person standard in such cases lacks content since the nature of the required evaluation presumes the exercise of personal judgment.

1-310. Subordinated Obligations.

An obligation may be issued as subordinated to performance of another obligation of the person obligated, or a creditor may subordinate its right to performance of an obligation by agreement with either the person obligated or another creditor of the person obligated. Subordination does not create a security interest as against either the common debtor or a subordinated creditor.

ARTICLE 2 - SALES

PART 1. SHORT TITLE, GENERAL CONSTRUCTION AND SUBJECT MATTER

2-101. Short Title.

This Article shall be known and may be cited as Uniform Commercial Code-Sales.

2-102. Scope; Certain Security and Other Transactions Excluded From This Article.

Unless the context otherwise requires, this Article applies to transactions in goods; it does not apply to any transaction which although in the form of an unconditional contract to sell or present sale is intended to operate only as a security transaction nor does this Article impair or repeal any statute regulating sales to consumers, farmers or other specified classes of buyers.

2-103. Definitions and Index of Definitions.

(1) In this Article unless the context otherwise requires

(a) "**Buyer**" means a person that buys or contracts to buy goods.

(b) "**Conspicuous**", with reference to a term, means so written, displayed, or presented that a reasonable person against which it is to operate ought to have noticed it. A term in an electronic record intended to evoke a response by an electronic agent is conspicuous if it is presented in a form that would enable a reasonably configured electronic agent to take it into account or react to it without review of the record by an individual. Whether a term is "conspicuous" or not is a decision for the court. Conspicuous terms include the following:

(i) for a person:

(A) a heading in capitals equal to or greater in size than the surrounding text, or in contrasting type, font, or color to the surrounding text of the same or lesser size; and

(B) language in the body of a record or display in larger type than the surrounding text, or in contrasting type, font, or color to the surrounding text of the same size, or set off from surrounding text of the same size by symbols or other marks that call attention to the language; and

(ii) for a person or an electronic agent, a term that is so placed in a record or display that the person or electronic agent may not proceed without taking action with respect to the particular term.

(c) "**Consumer**" means an individual who buys or contracts to buy goods that, at the time of contracting, are intended by the individual to be used primarily for personal, family, or household purposes.

(d) "**Consumer contract**" means a contract between a merchant seller and a consumer.

(e) "**Delivery**" means the voluntary transfer of physical possession or control of goods.

(f) "**Electronic**" means relating to technology having electrical, digital, magnetic, wireless, optical, electromagnetic, or similar capabilities.

(g) "**Electronic agent**" means a computer program or an electronic or other automated means used independently to initiate an action or respond to electronic records or performances in whole or in part, without review or action by an individual.

(h) "**Electronic record**" means a record created, generated, sent, communicated, received, or stored by electronic means.

(i) "**Foreign exchange transaction**" means a transaction in which one party agrees to deliver a quantity of a specified money or unit of account in consideration of the other party's agreement to deliver another quantity of a different money or unit of account either currently or at a future date, and in which delivery is to be through funds transfer, book entry accounting, or other form of payment order, or other agreed means to transfer a credit balance. The term includes a transaction of this type involving two or more moneys and spot, forward, option, or other products derived from underlying moneys and any combination of these transactions. The term does not include a transaction involving two or more moneys in which one or both of the parties is obligated to make physical delivery, at the time of contracting or in the future, of banknotes, coins, or other form of legal tender or specie.

[(j) Reserved]

[(j) "**Good faith**" means honesty in fact and the observance of reasonable commercial standards of fair dealing.]

> ***Legislative* Official Comments: *The definition of "good faith" should not be adopted if the jurisdiction has enacted this definition as part of Article 1.***

(k) "**Goods**" means all things that are movable at the time of identification to a contract for sale. The term includes future goods, specially manufactured goods, the unborn young of animals, growing crops, and other identified things attached to realty as described in Section 2-107. The term does not include information, the money in which the price is to be paid, investment securities under Article 8, the subject matter of foreign exchange transactions, or choses in action.

(l) "**Receipt of goods**" means taking physical possession of goods.

(m) "**Record**" means information that is inscribed on a tangible medium or that is stored in an electronic or other medium and is retrievable in perceivable form.

> ***Legislative* Official Comments: *The definition of "record" should not be adopted if the jurisdiction has enacted revised Article 1.***

(n) "**Remedial promise**" means a promise by the seller to repair or replace goods or to refund all or part of the price of goods upon the happening of a specified event.

(o) "**Seller**" means a person that sells or contracts to sell goods.

(p) "**Sign**" means, with present intent to authenticate or adopt a record:

(i) to execute or adopt a tangible symbol; or

(ii) to attach to or logically associate with the record an electronic sound, symbol, or process.

(2) Other definitions applying to this Article or to specified Parts thereof, and the sections in which they appear are:

"**Acceptance**".	Section 2-606.
"**Between merchants**".	Section 2-104.
"**Cancellation**".	Section 2-106(4).
"**Commercial unit**".	Section 2-105.
"**Conforming to contract**".	Section 2-106.
"**Contract for sale**".	Section 2-106.
"**Cover**".	Section 2-712.
"**Entrusting**".	Section 2-403.
"**Financing agency**".	Section 2-104.
"**Future Goods**".	Section 2-105.
"**Goods**".	Section 2-103.
"**Identification**".	Section 2-501.
"**Installment contract**".	Section 2-612.
"**Lot**".	Section 2-105.
"**Merchant**".	Section 2-104.
"**Person in position of Seller**".	Section 2-707.
"**Present sale**".	Section 2-106.
"**Sale**".	Section 2-106.
"**Sale on approval**".	Section 2-326.
"**Sale or return**".	Section 2-326.
"**Termination**".	Section 2-106.

(3) "Control" as provided in Section 7-106 and the following definitions in other Articles apply to this Article:

"**Check**".	Section 3-104(f).
"**Consignee**".	Section 7-102(3).
"**Consignor**".	Section 7-102(4).
"**Consumer Goods**".	Section 9-102(a)(23).
"**Dishonor**".	Section 3-502.
"**Draft**".	Section 3-104(e).
"**Honor**".	Section 5-102(a)(8).
"**Injunction against honor**".	Section 5-109(b).
"**Letter of credit**".	Section 5-102(a)(10).

(4) In addition Article 1 contains general definitions and principles of construction and interpretation applicable throughout this Article.

2-104. Definitions: "Merchant"; "Between Merchants"; "Financing Agency".

(1) "**Merchant**" means a person that deals in goods of the kind or otherwise holds itself out by occupation as having knowledge or skill peculiar to the practices or goods involved in the transaction or to which the knowledge or skill may be attributed by the person's employment of an agent or broker or other intermediary that holds itself out by occupation as having the knowledge or skill.

(2) "**Financing agency**" means a bank, finance company or other person that in the ordinary course of business makes advances against goods or documents of title or that by arrangement with either the seller or the buyer intervenes in ordinary course to make or collect payment due or claimed under the contract for sale, as by purchasing or paying the seller's draft or making advances against it or by merely taking it for collection whether or not documents of title accompany or are associated with the draft. The term includes also a bank or other person that similarly intervenes between persons that are in the position of seller and buyer in respect to the goods (Section 2-707).

(3) "**Between Merchants**" means in any transaction with respect to which both parties are chargeable with the knowledge or skill of merchants.

2-105. Definitions: Transferability; "Future" Goods; "Lot"; "Commercial Unit".

(1) Goods must be both existing and identified before any interest in them may pass. Goods that are not both existing and identified are "future" goods. A purported present sale of future goods or of any interest therein operates as a contract to sell.

(2) There may be a sale of a part interest in existing identified goods.

(3) An undivided share in an identified bulk of fungible goods is sufficiently identified to be sold although the quantity of the bulk is not determined. Any agreed proportion of the bulk or any quantity thereof agreed upon by number, weight, or other measure may to the extent of the seller's interest in the bulk be sold to the buyer that then becomes an owner in common.

(4) "**Lot**" means a parcel or a single article which is the subject matter of a separate sale or delivery, whether or not it is sufficient to perform the contract.

(5) "**Commercial unit**" means such a unit of goods as by commercial usage is a single whole for purposes of sale and division of which materially impairs its character or value on the market or in use. A commercial unit may be a single article (as a machine) or a set of articles (as a suite of furniture or an assortment of sizes) or a quantity (as a bale, gross, or carload) or any other unit treated in use or in the relevant market as a single whole.

2-106. Definitions: "Contract"; "Agreement"; "Contract for sale"; "Sale"; "Present sale"; "Conforming" to Contract; "Termination"; "Cancellation".

(1) In this Article unless the context otherwise requires "**contract**" and "**agreement**" are limited to those relating to the present or future sale of goods. "**Contract for sale**" includes both a present sale of goods and a contract to sell goods at a future time. A "**sale**" consists in the passing of title from the seller to the buyer for a price (Section 2-401). A "**present sale**" means a sale which is accomplished by the making of the contract.

(2) Goods or conduct including any part of a performance are "**conforming**" or conform to the contract when they are in accordance with the obligations under the contract.

(3) "**Termination**" occurs when either party pursuant to a power created by agreement or law puts an end to the contract otherwise than for its breach. On "termination" all obligations which are still executory on both sides are discharged but any right based on prior breach or performance survives.

(4) "**Cancellation**" occurs when either party puts an end to the contract for breach by the other and its effect is the same as that of "termination" except that the cancelling party also retains any remedy for breach of the whole contract or any unperformed balance.

2-107. Goods to Be Severed From Realty: Recording.

(1) A contract for the sale of minerals or the like (including oil and gas) or a structure or its materials to be removed from realty is a contract for the sale of goods within this Article if they are to be severed by the seller but until severance a purported present sale thereof which is not effective as a transfer of an interest in land is effective only as a contract to sell.

(2) A contract for the sale apart from the land of growing crops or other things attached to realty and capable of severance without material harm thereto but not described in subsection (1) or of timber to be cut is a contract for the sale of goods within this Article whether the subject matter is to be severed by the buyer or by the seller even though it forms part of the realty at the time of contracting, and the parties can by identification effect a present sale before severance.

(3) The provisions of this section are subject to any third party rights provided by the law relating to realty records, and the contract for sale may be executed and recorded as a document transferring an interest in land and shall then constitute notice to third parties of the buyer's rights under the contract for sale.

2-108. Transactions Subject to Other Law

(1) A transaction subject to this article is also subject to any applicable:

(a) [list any certificate of title statutes of this State covering automobiles, trailers, mobile homes, boats, farm tractors, or the like], except with respect to the rights of a buyer in ordinary course of business under Section 2-403(2) which arise before a certificate of title covering the goods is effective in the name of any other buyer;

(b) rule of law that establishes a different rule for consumers; or

(c) statute of this state applicable to the transaction, such as a statute dealing with:

(i) the sale or lease of agricultural products;

(ii) the transfer of human blood, blood products, tissues, or parts;

(iii) the consignment or transfer by artists of works of art or fine prints;

(iv) distribution agreements, franchises, and other relationships through which goods are sold;

(v) the misbranding or adulteration of food products or drugs; and

(vi) dealers in particular products, such as automobiles, motorized wheelchairs, agricultural equipment, and hearing aids.

(2) Except for the rights of a buyer in ordinary course of business under subsection (1)(a), in the event of a conflict between this article and a law referred to in subsection (1), that law governs.

(3) For purposes of this article, failure to comply with a law referred to in subsection (1) has only the effect specified in that law.

(4) This article modifies, limits, and supersedes the federal Electronic Signatures in Global and National Commerce Act, 15 U.S.C. Section 7001 et seq., except that nothing in this article modifies, limits, or supersedes Section 7001(c) of that Act or authorizes electronic delivery of any of the notices described in Section 7003(b) of that Act.

2-112 MANIFESTING ASSENT; OPPORTUNITY TO REVIEW.

Uniform Law Source: Restatement (Second) of Contracts 19.

Definitional Cross References. Section 102: "Agreement"; "Authenticate"; "Copy"; "Electronic"; "Electronic agent"; "Delivery"; "Information"; "Informational Rights"; "Knowledge"; "Mass-market license"; "Person"; "Record"; "Return"; "Term". Section 114: "Reason to know".

Official Comments:

1. *Scope of Section.* This section provides standards for "manifestation of assent" and "opportunity to review," important concepts for making contracts in electronic commerce. In this Act, "opportunity to review" a record is a precondition to manifesting assent to it. "Manifesting assent" as a concept has several roles in common law and this Act. It is: 1) one method by which a party agrees to (accepts) a contract; 2) a method by which a party may adopt terms of a record as the terms of a contract; and 3) if required by this Act, a means of assenting to a particular term. In most cases, the same acts accomplish both the first and second result.

2. *General Theme.* The term, "manifesting assent," comes from *Restatement (Second) of Contracts* § 19. This section corresponds substantively to *Restatement § 19* but more fully explicates the concept. Codification in this Act creates uniformity in terminology and application that is lacking in common law.

The basic principle is that words are not the only means of indicating assent to a contract or its terms and that conduct can often convey assent as, or more clearly as, can words. This is an important principle in electronic contracting where most interactions involve conduct, rather than spoken words. The *Restatement* states: "The manifestation of assent may be made wholly or partly by written or spoken words or by other acts or by failure to act." *Restatement (Second) of Contracts* § 19(1). Subsection (a) adopts this view. Subsection (b) adapts the principle to use of electronic agents. Manifesting assent does not require any specific formality of language or conduct.

In this Act, determining whether a person manifested assent to a record or term requires analysis of three issues:

- **First**, the person must have knowledge of the record or term or an opportunity to review it before assenting. As described in subsection (e), opportunity to review requires that the record be made available in a manner that ought to call it to the attention of a reasonable person and in a form that readily permits review. Subsection (e) also requires a right of return if the record is not presented before initial performance.
- **Secon**d, given an opportunity to review, the person must do something that assents to the terms. The person may authenticate the record or term, express assent verbally, or intentionally engage in conduct with reason to know that in the circumstances the conduct indicates assent. *Restatement (Second) of Contracts* § 19. Conduct manifests assent only if the party's behavior was intentional and with knowledge or reason to know that the other party would infer assent from it. As in the *Restatement* the conduct can include inaction if the circumstances so indicate.
- **Third**, the conduct, statement, or authentication must be attributable to the person. General agency law and Section 213 provide standards for attribution.

3. Manifesting Assent.

*a***.** *Assent by Statements or Authentication.* As under common law, a person can assent to a record or term by stating its consent or by "authenticating" the record or term. Authentication either is a "signature" or an electronic equivalent. The term "authenticate" is adopted to enable electronic commerce, but the underlying concepts relating to signature remain the same. See Section 102 (definition of authentication).

*b***.** *Assent by Conduct.* Assent occurs if a person acts (or fails to act) having reason to know its behavior will be viewed by the other party as indicating assent. Whether this occurs depends on the circumstances. As in common law, assent does not require proof of a person's subjective intent or purpose, but focuses on objective factors, including whether there was an act or a failure to act voluntarily engaged in with reason to know that the inference of assent would be drawn. Actions objectively indicating assent are effective even though the actor may subjectively intend otherwise. This follows traditional contract law of "objective" assent. It is especially important in electronic commerce where many transactions do not involve contact between individuals. Parties on both sides must rely on objective **acts** indicating acceptance. Doctrines of mistake as well as the law relating to fraud and duress apply in appropriate cases.

Assent in common law and in this Act does not require that a party be able to negotiate or modify terms. But the assenting behavior must be intentional (voluntary). This is satisfied if the alternative of refusing the deal or terms exists even if refusing terms leaves no alternative source for the subject matter of the contract. It is not satisfied if the act treated as assent is one which the assenting party cannot

reasonably avoid doing even if it refuses the contract, such as blinking one's eyes. Under this same general standard, common law courts have used common sense in applying this test and will do so under this Act. Similarly, an act that does not bear a relationship to a contract or a record might fail under the general standard. Acts that occur in context of a mutual express reservation of the right to defer agreement do not manifest assent to a contract that neither party intended; neither party has any reason to believe that its conduct will suggest assent to the other party.

Actual knowledge that particular conduct will be viewed as assent suffices. Also, actions are treated as assent if a person has "reason to know" that they will lead the other party to the inference that there was assent. Factors that relate to this issue include: the ordinary expectations of similar persons in similar contexts; language on a display, package, or otherwise that is made available to the party before it acts; the fact that the party can decline and return the information without using it, but decides to use the information; information about contract terms communicated to the actor before conduct occurred; standards and practices of the business, trade or industry of which the person has reason to know; and other relevant factors.

The reason to know standard is not met where computer information is sent to a recipient unsolicited under terms that purport to create a binding contract by failure to object to the unsolicited sending. In such cases, it is not reasonable for the sending party to infer assent from silence and, therefore, the threshold for manifesting assent is not met.

c. *Assent by Electronic Agents.* Assent may occur through automated systems, described in this Act as "electronic agents." Either or both parties (including consumers) may use electronic agents. The reduced transaction costs from the technology are immense for consumers and for providers of information. However, when dealing with electronic agent assent, that assent cannot be based on knowledge or reason to know of the principal since programs are capable of neither and since the remote, automated nature of the interaction may preclude either individual party from any awareness (this does not, however, preclude persons who program agents from having reason to know of usage of trade and the like or preclude that knowledge from being programmed into the agent.

The issues is not relevant under subsection (b) because the subsection focuses on the acts, not the knowledge, of the agent). Subsection (b) focuses on whether there was an authentication or whether in the overall circumstances, the electronic operations indicate assent. For both electronic agents and individuals, manifesting assent requires a prior opportunity to review. Subsection (e)(2) buttresses this automated assent by providing that, for an electronic agent, the opportunity has been made available only if the record or term is presented in such a way that a reasonably configured electronic agent could react to it. The capability of an automated system to react and an assessment of the implications of its actions are more appropriate measures of assent than concepts of knowledge or reason to know.

d. *Assent to particular terms.* This Act distinguishes assent to a record and, when required by this Act or other law, assent to a particular term within the record. Assent to a record relates to the record as a whole and generally encompasses all terms of the record. Section 208. Assent to a particular term, if required, requires acts that specifically relate to that particular term. This is like a requirement that a party "initial" an individual clause of a record to make it effective. One act, however, may assent to both the record and the term if the circumstances, including the language of the record, clearly indicate to the party that doing the act is also assent to the particular term.

4. *Assent and Terms of an Agreement.* Manifestation of assent to a record containing contract terms is not the only way in which parties establish their bargain. This Act does not alter recognition of those other methods of agreeing to terms. For example, a product description can become part of an agreement without a manifestation of assent to a record repeating that description; in appropriate cases, the product description defines the bargain itself. This is implicit in the basic principle that this Act, like Article 2 of the U.C.C., defines the agreement based on the commercial circumstances. A party that markets a database of names of consumer attorneys can rely on the fact that the product need only contain consumer attorneys because this is the basic bargain it proposes; the provider is not required to seek manifest assent to a record stating that part of the deal.

Similarly, the licensee can rely on the fact that the database must contain consumer attorneys, not other lawyers. The described nature of the product defines the bargain if the party makes the acquisition on that basis. If a product is clearly identified on the package or in representations to the licensee as being for consumer use only, the terms are effective without requiring language in a record restating the description or conduct assenting to that record. Of course, if the nature of the product is not obvious and there is no assent to a contract defining that nature or other agreement to it, such conditions might not become part of the agreement.

In many cases, copyright or other intellectual property notices restrict use of a product, regardless of assent to contract terms. For example, common practice in video rentals places a notice on screen of limits on the customer's use under applicable copyright and criminal law, such as by precluding

commercial public performances. The enforceability of such notices typically does not depend on compliance with procedures of assent.

5. *Proof of Assent.* A wide range of behavior and interactions in commerce establish consent to a contract or particular terms. It is not possible to state the variety of options that might manifest assent. In the anonymous world of electronic commerce, however, one of the most important is by showing that a process existed that required an authentication or other assent in order to proceed in an automated system. This is recognized in subsection (d). Of course, the procedure not only must exist, but be in place in a manner that the person must have engaged in it.

Subsection (d) also contains language to encourage use of duplicative consent procedures when appropriate. It makes clear that if the assenting party has an opportunity to confirm or deny assent before proceeding to obtain or use information, confirmation meets the requirement of subsection (a)(2). This alternative does not impair the effectiveness of a single indication of assent, by an electronic or other act; it simply provides a safe harbor for those obtaining electronic assent and a opportunity to confirm or deny assent for those who provide assent.

Illustration 1: The registration screen for NY Online prominently states: "Please read the License. It contains important terms about your use and our obligations with respect to the information. If you agree to the license it, indicate this by clicking the "I agree" button. If you do not agree, click "I decline". The on-screen buttons are clearly identified. The underlined text is a hypertext link which, if selected, promptly displays the license. A party that indicates "I agree" manifests assent to the license and adopts its terms.

Illustration 2: The first display screen of an on-line stock-quote service requires that the potential licensee enter their name, address and credit card number. After entering the information and striking the "enter" key, the licensee has access to the data and receives a monthly bill. Somewhere below the above hidden in other small print, is the statement: "Terms and conditions of service; disclaimers" indicating a hyperlink to the terms. The customer's attention is not called to this sentence, nor is the customer asked to react to it. Even though entering name and identification, coupled with using the service, assents to a contract, there is no assent to the "terms of service" and disclaimer since there is no act indicating assent to the record containing the terms. A court would determine the contract terms on other grounds, including the default rules of this Act and usage of trade.

Illustration 3: The purchase order screen of an on-line software provider's service provides the terms of the license, a space to indicate the software purchased, and two on-screen buttons indicating "I agree" and "I decline" respectively. A user that completes the order and indicates "I agree", causes the system to move to a second screen. This second screen summarizes the order and asks the user to click confirming its order, or canceling it. Under this subsection (d), this double assent sequence satisfies subsection (a)(2) regarding the intentional conduct and reason to know standard. It also satisfies the error correction procedure in Section 214.

6. *Authority to Act.* The person manifesting assent must be one that can bind the party seeking the benefits or being charged with the obligations or restrictions of the agreement. In general, this Act treats this issue as a question of attribution: are the assent-producing acts attributable to this particular person? A person that desires to enforce terms against another must establish that it dealt with an individual that had authority to bind the person or, at least, establish that the person accepted the benefits of the contract or otherwise ratified the acts.

If the individual who assented did not have authority and the conduct was not ratified or otherwise adopted, there may be no assent as to the party "represented," but only as to the individual who acted. If this occurs, both the purported principal and the relying party may be exposed to loss: the relying party (e.g., licensor) risks loss of its terms, while the purported principal ("licensee" using information not obtained through a proper agent) risks that use of the information infringes a copyright or patent. There must be an adequate connection between the individual who had the opportunity to review and who manifested assent and the person one whose acts constitute assent. Of course, a party with authority can delegate that authority to another. Thus, a CEO may implicitly authorize her secretary to agree to a license when the CEO instructs the secretary to sign up for legal materials online or to install a newly acquired program that is subject to a screen license.

Questions of this sort arise under agency law as augmented in this Act. In appropriate cases, rules in this Act on attribution play a role in resolving whether the ultimate party is bound to the contract terms. Section 213 deals with when, in an electronic environment, a party is bound to records purporting to have come from that party. Other law governs questions of ordinary agency.

7. *Third Party Service Providers.* Assent requires conduct by the party to be bound or its agents. In many Internet situations, a party is able to reach a particular system because of services provided by a third party communications or other service provider. In such cases, the services provider typically does

not intend to engage in a contractual relationship with the provider of the information. While the "customer" activity may constitute assent to terms, it does not bind the service provider since the service provider's actions are in the nature of transmissions and making information access available, not assent to a contractual relationship.

This Act is clear that service providers – providers of online services, network access, or the operation of facilities thereof – do not manifest assent to a contractual relationship simply from their provision of such services, including but not limited to transmission, routing, providing connections, linking or storage of material at the request or initiation of a person other than the service provider. If, for example, a telecommunications company provided the routing for a user to reach a particular online location, the fact that the user of the service might assent to a contract at that location does not mean that the service provider has done so. The conduct of the customer does not bind the service provider.

Of course, in some on-line systems the service provider has direct contractual relationships with the content providers or may desire access to and use the information on its own behalf, and therefore may assent to terms in order to obtain access. In the absence of these circumstances, however, the mere fact that the third-party service provider enables the customer to reach the information site does not constitute assent to the terms at that site.

8. *Opportunity to Review.* A manifestation of assent under this Act cannot occur unless there was an opportunity to review the record or term to which the assent is directed. Common law is not clear on this requirement, but it reflects simple fairness and codifies or adapts concepts preventing procedural unconscionability. For a "person," an opportunity to review requires that a record be made available in a manner that ought to call it to the attention of a reasonable person and permit review. This requirement, of course, is clearly met if the person actually knows the terms of the record or has reason to know that the record or term exists in a form and location that in the circumstances permits review of it or a copy of it. For an electronic agent, an opportunity to review exists only if the record is one to which a reasonably configured electronic agent could respond.

a*. Declining to Use the Opportunity to Review.* An opportunity to review does not require that the person use that opportunity; the condition is met even if the person foregoes the opportunity. Contract terms offered for review during an over-the-counter transaction or made available in a binder as may be required under federal law give an opportunity to review even if the person does not use that opportunity. This is not changed because the party desires to complete the transaction rapidly, is under pressure to do so, or because the party has other demands on its attention, unless the one party intentionally manipulates the circumstances to induce the other party not to review the record.

b*. Permits Review.* How a record is made available for review differs for electronic and paper records. In both, however, a record is not available for review if access to it is so time-consuming or cumbersome as to effectively preclude review. It must be presented in a way as to reasonably permit review. In an electronic system, a record promptly accessible through an electronic link ordinarily qualifies. Actions that comply with federal or other applicable consumer laws that require making contract terms or disclosure available, or that provide standards for doing so, satisfy this requirement.

c**.** *Right to Return.* In commerce, there are many circumstances when terms in a record are not available until after there is a commitment to the transaction. As indicated in subsection (e), in most such cases there is no opportunity to review unless the party can return the product (or in the case of a vendor that refuses the other party's terms, recover the product) and receive reimbursement of any payments if it rejects the contract terms contained in the record. This rule does not exist in prior law but creates important protection for the party asked to assent. When the right to return is established by agreement, rather than by operation of law, it must be part of the express terms such that the person can become aware of it.

This rule provides strong incentive for a licensor to make the terms of the license available up-front if commercially practicable. Doing so avoids the obligations regarding a right of return stated in this section and in Sections 209 and 613. In addition, under Sections 208 and 209, when presentation of initial terms is deferred in this manner, the terms cannot become part of the contract unless the other party had reason to know that some terms would be later presented. Thus, a decision to defer presentation of terms without an important commercial reason to do so, may result in substantial costs and uncertainty. The required return right exists only for the first licensee.

Failure to provide a right to return in cases of records presented after the initial commitment to the transaction does not invalidate the agreement, but creates the risk that the terms will not be assented to by the party to which they were presented. The enforceable terms of the agreement must be determined by consideration of all the circumstances, including the expectations of the parties, applicable usage of trade and course of dealing, and the property rights, if any, involved in the transaction. Section 210. In such cases, courts should be careful to avoid unwarranted forfeiture or unjust enrichment regarding the conditions or terms of the agreement. An agreement whose payment

and other agreed terms reflect a right to use for consumer purposes only cannot be transformed into an unlimited right of commercial use by a failure of assent.

9. *Modifications and Layered Contracting.* The return provisions do not apply to or alter law on modification of an agreement or the law regarding the agreed right of a party to specify particulars of performance. Similarly, as outlined in subsection (e), the return right does not apply in commercial contexts where parties begin performance in the expectation that a record containing contract terms will be presented and adopted later. This is a common occurrence in development and other complex contracts and this Act does not disturb that commercial practice.

10. *Modification of Rules.* Section 113(a) precludes alteration of some portions of Section 211 by agreement. Subsection (f), however, allows parties, by a prior agreement, to restructure what does and does not constitute assent with respect to future conduct; this restructuring may call for more or fewer protections than are found in Section 211 or this Act. This is important for the many cases in which electronic commerce occurs through repeated exchanges pursuant to prior agreements. The requirements of assent in such cases can just as well be found in the original agreement as in subsequent conduct. In most cases, the prior agreement would satisfy the requirements of this section in full even as to the subsequent transactions.

PART 2. FORM, FORMATION AND READJUSTMENT OF CONTRACT [Table of Contents]

2-201. Formal Requirements; Statute of Frauds.

(1) A contract for the sale of goods for the price of $5,000 or more is not enforceable by way of action or defense unless there is some record sufficient to indicate that a contract for sale has been made between the parties and signed by the party against which enforcement is sought or by the party's authorized agent or broker. A record is not insufficient because it omits or incorrectly states a term agreed upon but the contract is not enforceable under this subsection beyond the quantity of goods shown in the record.

(2) Between merchants if within a reasonable time a record in confirmation of the contract and sufficient against the sender is received and the party receiving it has reason to know its contents, it satisfies the requirements of subsection (1) against the recipient unless notice of objection to its contents is given in a record within 10 days after it is received.

(3) A contract that does not satisfy the requirements of subsection (1) but which is valid in other respects is enforceable:

(a) if the goods are to be specially manufactured for the buyer and are not suitable for sale to others in the ordinary course of the seller's business and the seller, before notice of repudiation is received and under circumstances that reasonably indicate that the goods are for the buyer, has made either a substantial beginning of their manufacture or commitments for their procurement;

(b) if the party against which enforcement is sought admits in the party's pleading, or in the party's testimony or otherwise under oath that a contract for sale was made, but the contract is not enforceable under this paragraph beyond the quantity of goods admitted; or

(c) with respect to goods for which payment has been made and accepted or which have been received and accepted (Sec. 2-606).

(4) A contract that is enforceable under this section is not unenforceable merely because it is not capable of being performed within one year or any other period after its making.

2-202. Final Expression in a Record: Parol or Extrinsic Evidence.

(1) Terms with respect to which the confirmatory records of the parties agree or which are otherwise set forth in a record intended by the parties as a final expression of their agreement with respect to such terms as are included therein may not be contradicted by evidence of any prior agreement or of a contemporaneous oral agreement but may be supplemented by evidence of:

(a) course of performance, course of dealing, or usage of trade (Section 1-303); and

(b) consistent additional terms unless the court finds the record to have been intended also as a complete and exclusive statement of the terms of the agreement .

(2) Terms in a record may be explained by evidence of course of performance, course of dealing, or usage of trade without a preliminary determination by the court that the language used is ambiguous.

2-203. Seals Inoperative.

The affixing of a seal to a record evidencing a contract for sale or an offer to buy or sell goods does not constitute the record a sealed instrument. The law with respect to sealed instruments does not apply to such a contract or offer.

2-204. Formation in General.

(1) A contract for sale of goods may be made in any manner sufficient to show agreement, including offer and acceptance, conduct by both parties which recognizes the existence of a contract, the interaction of electronic agents, and the interaction of an electronic agent and an individual.

(2) An agreement sufficient to constitute a contract for sale may be found even if the moment of its making is undetermined.

(3) Even if one or more terms are left open, a contract for sale does not fail for indefiniteness if the parties have intended to make a contract and there is a reasonably certain basis for giving an appropriate remedy.

(4) Except as otherwise provided in Sections 2-211 through 2-213, the following rules apply:

(a) A contract may be formed by the interaction of electronic agents of the parties, even if no individual was aware of or reviewed the electronic agents' actions or the resulting terms and agreements.

(b) A contract may be formed by the interaction of an electronic agent and an individual acting on the individual's own behalf or for another person. A contract is formed if the individual takes actions that the individual is free to refuse to take or makes a statement, and the individual has reason to know that the actions or statement will:

(i) cause the electronic agent to complete the transaction or performance; or

(ii) indicate acceptance of an offer, regardless of other expressions or actions by the individual to which the electronic agent cannot react.

2-205. Firm Offers.

An offer by a merchant to buy or sell goods in a signed record that by its terms gives assurance that it will be held open is not revocable, for lack of consideration, during the time stated or if no time is stated for a reasonable time, but in no event may such period of irrevocability exceed three months; but in no event may the period of irrevocability exceed three months. Any such term of assurance in a form supplied by the offeree must be separately signed by the offeror.

2-206. Offer and Acceptance in Formation of Contract.

(1) Unless otherwise unambiguously indicated by the language or circumstances

(a) an offer to make a contract shall be construed as inviting acceptance in any manner and by any medium reasonable in the circumstances:

(b) an order or other offer to buy goods for prompt or current shipment shall be construed as inviting acceptance either by a prompt promise to ship or by the prompt or current shipment of conforming or nonconforming goods, but the shipment of nonconforming goods is not an acceptance if the seller seasonably notifies the buyer that the shipment is offered only as an accommodation to the buyer.

(2) If the beginning of a requested performance is a reasonable mode of acceptance, an offeror that is not notified of acceptance within a reasonable time may treat the offer as having lapsed before acceptance.

(3) A definite and seasonable expression of acceptance in a record operates as an acceptance even if it contains terms additional to or different from the offer.

2-207. Terms of Contract; Effect of Confirmation.

Subject to Section 2-202, if (i) conduct by both parties recognizes the existence of a contract although their records do not otherwise establish a contract, (ii) a contract is formed by an offer and acceptance, or (iii) a contract formed in any manner is confirmed by a record that contains terms additional to or different from those in the contract being confirmed, the terms of the contract are:

(a) terms that appear in the records of both parties;

(b) terms, whether in a record or not, to which both parties agree; and

(c) terms supplied or incorporated under any provision of this Act.

[2-208. Reserved]

2-209. Modification, Rescission and Waiver.

(1) An agreement modifying a contract within this Article needs no consideration to be binding.

(2) An agreement in a signed record which excludes modification or rescission except by a signed record may not be otherwise modified or rescinded, but except as between merchants such a requirement in a form supplied by the merchant must be separately signed by the other party.

(3) The requirements of Section 2-201 must be satisfied if the contract as modified is within its provisions.

(4) Although an attempt at modification or rescission does not satisfy the requirements of subsection (2) or (3), it may operate as a waiver.

(5) A party that has made a waiver affecting an executory portion of a contract may retract the waiver by reasonable notification received by the other party that strict performance will be required of any term waived, unless the retraction would be unjust in view of a material change of position in reliance on the waiver.

2-210. Delegation of Performance; Assignment of Rights.

(1) If the seller or buyer assigns rights under a contract, the following rules apply:

(a) Subject to paragraph (b) and except as otherwise provided in Section 9-406 or as otherwise agreed, all rights of the seller or the buyer may be assigned unless the assignment would materially change the duty of the other party, increase materially the burden or risk imposed on that party by the contract, or impair materially that party's chance of obtaining return performance. A right to damages for breach of the whole contract or a right arising out of the assignor's due performance of its entire obligation may be assigned despite an agreement otherwise.

(b) The creation, attachment, perfection, or enforcement of a security interest in the seller's interest under a contract is not an assignment that materially changes the duty of or materially increases the burden or risk imposed on the buyer or materially impairs the buyer's chance of obtaining return performance under paragraph (a) unless, and only to the extent that, enforcement of the security interest results in a delegation of a material performance of the seller. Even in that event, the creation, attachment, perfection, and enforcement of the security interest remain effective. However, the seller is liable to the buyer for damages caused by the delegation to the extent that the damages could not reasonably be prevented by the buyer, and a court may grant other appropriate relief, including cancellation of the contract or an injunction against enforcement of the security interest or consummation of the enforcement.

(2) If the seller or buyer delegates performance of its duties under a contract, the following rules apply:

(a) A party may perform its duties through a delegate unless otherwise agreed or unless the other party has a substantial interest in having the original promisor perform or control the acts required by the contract. Delegation of performance does not relieve the delegating party of any duty to perform or liability for breach.

(b) Acceptance of a delegation of duties by the assignee constitutes a promise to perform those duties. The promise is enforceable by either the assignor or the other party to the original contract.

(c) The other party may treat any delegation of duties as creating reasonable grounds for insecurity and may without prejudice to its rights against the assignor demand assurances from the assignee under Section 2--609.

(d) A contractual term prohibiting the delegation of duties otherwise delegable under paragraph (a) is enforceable, and an attempted delegation is not effective.

(3) An assignment of "the contract" or of "all my rights under the contract" or an assignment in similar general terms is an assignment of rights and unless the language or the circumstances, as in an assignment for security, indicate the contrary, it is also a delegation of performance of the duties of the assignor.

(4) Unless the circumstances indicate the contrary, a prohibition of assignment of "the contract" is to be construed as barring only the delegation to the assignee of the assignor's performance.

2-211. Legal Recognition of Electronic Contracts, Records, and Signatures

(1) A record or signature may not be denied legal effect or enforceability solely because it is in electronic form.

(2) A contract may not be denied legal effect or enforceability solely because an electronic record was used in its formation.

(3) This article does not require a record or signature to be created, generated, sent, communicated, received, stored, or otherwise processed by electronic means or in electronic form.

(4) A contract formed by the interaction of an individual and an electronic agent under Section 2-204(4)(b) does not include terms provided by the individual if the individual had reason to know that the agent could not react to the terms as provided.

2-212. ATTRIBUTION

An electronic record or electronic signature is attributable to a person if it was the act of the person or the person's electronic agent or the person is otherwise legally bound by the act.

2-213. ELECTRONIC COMMUNICATION

(1) If the receipt of an electronic communication has a legal effect, it has that effect even if no individual is aware of its receipt.

(2) Receipt of an electronic acknowledgment of an electronic communication establishes that the communication was received but, in itself, does not establish that the content sent corresponds to the content received.

PART 3. GENERAL OBLIGATION AND CONSTRUCTION OF CONTRACT [Table of Contents]

2-301. General Obligations of Parties.

The obligation of the seller is to transfer and deliver and that of the buyer is to accept and pay in accordance with the contract.

2-302. Unconscionable contract or Term.

(1) If the court as a matter of law finds the contract or any term of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable term, or it may so limit the application of any unconscionable term as to avoid any unconscionable result.

(2) If it is claimed or appears to the court that the contract or any term thereof may be unconscionable the parties shall be afforded a reasonable opportunity to present evidence as to its commercial setting, purpose, and effect to aid the court in making the determination.

2-303. Allocation or Division of Risks.

Where this Article allocates a risk or a burden as between the parties "unless otherwise agreed", the agreement may not only shift the allocation but may also divide the risk or burden.

2-304. Price Payable in Money, Goods, Realty, or Otherwise.

(1) The price may be made payable in money or otherwise. If it is payable in whole or in part in goods each party is a seller of the goods that the party is to transfer.

(2) Even if all or part of the price is payable in an interest in real property the transfer of the goods and the seller's obligations with reference to them are subject to this Article, but not the transfer of the interest in real property or the transferor's obligations in connection therewith.

2-305. Open Price Term.

(1) The parties if they so intend may conclude a contract for sale even if the price is not settled. In such a case the price is a reasonable price at the time for delivery if:

(a) nothing is said as to price;

(b) the price is left to be agreed by the parties and they fail to agree; or

(c) the price is to be fixed in terms of some agreed market or other standard as set or recorded by a third person or agency and it is not so set or recorded.

(2) A price to be fixed by the seller or by the buyer means a price to be fixed in good faith.

(3) If a price left to be fixed otherwise than by agreement of the parties fails to be fixed through fault of one party the other may at the party's option treat the contract as cancelled or the party may fix a reasonable price.

(4) If, however, the parties intend not to be bound unless the price is fixed or agreed and it is not fixed or agreed there is no contract. In such a case the buyer must return any goods already received or if unable to do so must pay their reasonable value at the time of delivery and the seller must return any portion of the price paid on account.

2-306. Output, Requirements and Exclusive Dealings.

(1) A term which measures the quantity by the output of the seller or the requirements of the buyer means such actual output or requirements as may occur in good faith, except that no quantity unreasonably disproportionate to any stated estimate or in the absence of a stated estimate to any normal or otherwise comparable prior output or requirements may be tendered or demanded.

(2) A lawful agreement by either the seller or the buyer for exclusive dealing in the kind of goods concerned imposes unless otherwise agreed an obligation by the seller to use best efforts to supply the goods and by the buyer to use best efforts to promote their sale.

2-307. Delivery in Single Lot or Several Lots.

Unless otherwise agreed all goods called for by a contract for sale must be tendered in a single delivery and payment is due only on such tender but where the circumstances give either party the right to make or demand delivery in lots the price if it can be apportioned may be demanded for each lot.

2-308. Absence of Specified Place for Delivery.

Unless otherwise agreed

(a) the place for delivery of goods is the seller's place of business or if none, the seller's residence; but

(b) in a contract for sale of identified goods which to the knowledge of the parties at the time of contracting are in some other place, that place is the place for their delivery; and

(c) documents of title may be delivered through customary banking channels.

2-309. Absence of Specific Time Provisions; Notice of Termination.

(1) The time for shipment or delivery or any other action under a contract if not provided in this Article or agreed upon shall be a reasonable time.

(2) If the contract provides for successive performances but is indefinite in duration, it is valid for a reasonable time but unless otherwise agreed may be terminated at any time by either party.

(3) Termination of a contract by one party except on the happening of an agreed event requires that reasonable notification be received by the other party and an agreement dispensing with notification is invalid if its operation would be unconscionable. A term specifying standards for the nature and timing of notice is enforceable if the standards are not manifestly unreasonable.

2-310. Open Time for Payment or Running of Credit; Authority to Ship Under Reservation.

Unless otherwise agreed

(a) payment is due at the time and place at which the buyer is to receive the goods even though the place of shipment is the place of delivery;

(b) if the seller is required or authorized to send the goods, the seller may ship them under reservation, and may tender the documents of title, but the buyer may inspect the goods after their arrival before payment is due unless the inspection is inconsistent with the terms of the contract (Section 2-513);

(c) if tender of delivery is agreed to be made by way of documents of title otherwise than by paragraph (b), then payment is due regardless of where the goods are to be received (i) at the time and place at which the buyer is to receive delivery of the tangible documents, or (ii) at the time the buyer is to receive delivery of the electronic documents and at the seller's place of business or if none, the seller's residence; and

(d) if the seller is required or authorized to ship the goods on credit the credit period runs from the time of shipment but postdating the invoice or delaying its dispatch will correspondingly delay the starting of the credit period.

2-311. Options and Cooperation Respecting Performance.

(1) An agreement for sale which is otherwise sufficiently definite (Section 2-204(3)) to be a contract is not made invalid by the fact that it leaves particulars of performance to be specified by one of the parties. Any such specification must be made in good faith and within limits set by commercial reasonableness.

(2) Unless otherwise agreed, specifications relating to assortment of the goods are at the buyer's option and specifications or arrangements relating to shipment are at the seller's option.

(3) If the specification would materially affect the other party's performance but is not seasonably made or if one party's cooperation is necessary to the agreed performance of the other but is not seasonably forthcoming, the other party in addition to all other remedies:

(a) is excused for any resulting delay in that party's performance; and

(b) may also either proceed to perform in any reasonable manner or after the time for a material part of that party's performance treat the failure to specify or to cooperate as a breach by failure to deliver or accept the goods.

2-312. Warranty of Title and Against Infringement; Buyer's Obligation Against Infringement.

(1) Subject to subsection (3), there is in a contract for sale a warranty by the seller that:

(a) the title conveyed shall be good and its transfer rightful and shall not unreasonably expose the buyer to litigation because of any colorable claim to or interest in the goods; and

(b) the goods shall be delivered free from any security interest or other lien or encumbrance of which the buyer at the time of contracting has no knowledge.

(2) Unless otherwise agreed, a seller that is a merchant regularly dealing in goods of the kind warrants that the goods shall be delivered free of the rightful claim of any third person by way of infringement or the like but a buyer that furnishes specifications to the seller must hold the seller harmless against any such claim that arises out of compliance with the specifications.

(3) A warranty under this section may be disclaimed or modified only by specific language or by circumstances that give the buyer reason to know that the seller does not claim title, that the seller is purporting to sell only the right or title as the seller or a third person may have, or that the seller is selling subject to any claims of infringement or the like.

2-313. Express Warranties by Affirmation, Promise, Description, Sample.

(1) In this section, "**immediate buyer**" means a buyer that enters into a contract with the seller.

(2) Express warranties by the seller to the immediate buyer are created as follows:

(a) Any affirmation of fact or promise made by the seller which relates to the goods and becomes part of the basis of the bargain creates an express warranty that the goods shall conform to the affirmation or promise.

(b) Any description of the goods which is made part of the basis of the bargain creates an express warranty that the goods shall conform to the description.

(c) Any sample or model that is made part of the basis of the bargain creates an express warranty that the whole of the goods shall conform to the sample or model.

(3) It is not necessary to the creation of an express warranty that the seller use formal words such as "warrant" or "guarantee" or that the seller have a specific intention to make a warranty, but an affirmation merely of the value of the goods or a statement purporting to be merely the seller's opinion or commendation of the goods does not create a warranty.

(4) Any remedial promise made by the seller to the immediate buyer creates an obligation that the promise will be performed upon the happening of the specified event.

2-313A Obligation to Remote Purchaser Created by Record Packaged With or Accompanying Goods

(1) In this section:

(a) "**Immediate buyer**" means a buyer that enters into a contract with the seller.

(b) "**Remote purchaser**" means a person that buys or leases goods from an immediate buyer or other person in the normal chain of distribution.

(2) This section applies only to new goods and goods sold or leased as new goods in a transaction of purchase in the normal chain of distribution.

(3) If in a record packaged with or accompanying the goods the seller makes an affirmation of fact or promise that relates to the goods, provides a description that relates to the goods, or makes a remedial promise, and the seller reasonably expects the record to be, and the record is, furnished to the remote purchaser, the seller has an obligation to the remote purchaser that:

(a) the goods will conform to the affirmation of fact, promise, or description unless a reasonable person in the position of the remote purchaser would not believe that the affirmation of fact, promise, or description created an obligation; and

(b) the seller will perform the remedial promise.

(4) It is not necessary to the creation of an obligation under this section that the seller use formal words such as "warrant" or "guarantee" or that the seller have a specific intention to undertake an obligation, but an affirmation merely of the value of the goods or a statement purporting to be merely the seller's opinion or commendation of the goods does not create an obligation.

(5) The following rules apply to the remedies for breach of an obligation created under this section:

(a) The seller may modify or limit the remedies available to the remote purchaser if the modification or limitation is furnished to the remote purchaser no later than the time of purchase or if the modification or limitation is contained in the record that contains the affirmation of fact, promise, or description.

(b) Subject to a modification or limitation of remedy, a seller in breach is liable for incidental or consequential damages under Section 2-715, but not for lost profits.

(c) The remote purchaser may recover as damages for breach of a seller's obligation arising under subsection (3) the loss resulting in the ordinary course of events as determined in any reasonable manner.

(6) An obligation that is not a remedial promise is breached if the goods did not conform to the affirmation of fact, promise, or description creating the obligation when the goods left the seller's control.

2-313B Obligation to Remote Purchaser Created by Communication to the Public

(1) In this section:

(a) "**Immediate buyer**" means a buyer that enters into a contract with the seller.

(b) "**Remote purchaser**" means a person that buys or leases goods from an immediate buyer or other person in the normal chain of distribution.

(2) This section applies only to new goods and goods sold or leased as new goods in a transaction of purchase in the normal chain of distribution.

(3) If in an advertisement or a similar communication to the public a seller makes an affirmation of fact or promise that relates to the goods, provides a description that relates to the goods, or makes a remedial promise, and the remote purchaser enters into a transaction of purchase with knowledge of and with the expectation that the goods will conform to the affirmation of fact, promise, or description, or that the seller will perform the remedial promise, the seller has an obligation to the remote purchaser that:

(a) the goods will conform to the affirmation of fact, promise, or description unless a reasonable person in the position of the remote purchaser would not believe that the affirmation of fact, promise, or description created an obligation; and

(b) the seller will perform the remedial promise.

(4) It is not necessary to the creation of an obligation under this section that the seller use formal words such as "warrant" or "guarantee" or that the seller have a specific intention to undertake an obligation, but an affirmation merely of the value of the goods or a statement

purporting to be merely the seller's opinion or commendation of the goods does not create an obligation.

(5) The following rules apply to the remedies for breach of an obligation created under this section:

(a) The seller may modify or limit the remedies available to the remote purchaser if the modification or limitation is furnished to the remote purchaser no later than the time of purchase. The modification or limitation may be furnished as part of the communication that contains the affirmation of fact, promise, or description.

(b) Subject to a modification or limitation of remedy, a seller in breach is liable for incidental or consequential damages under Section 2-715, but not for lost profits.

(c) The remote purchaser may recover as damages for breach of a seller's obligation arising under subsection (3) the loss resulting in the ordinary course of events as determined in any reasonable manner.

(6) An obligation that is not a remedial promise is breached if the goods did not conform to the affirmation of fact, promise, or description creating the obligation when the goods left the seller's control.

2-314. Implied Warranty: Merchantability; Usage of Trade.

(1) Unless excluded or modified (Section 2-316), a warranty that the goods shall be merchantable is implied in a contract for their sale if the seller is a merchant with respect to goods of that kind. Under this section the serving for value of food or drink to be consumed either on the premises or elsewhere is a sale.

(2) Goods to be merchantable must be at least such as:

(a) pass without objection in the trade under the contract description;

(b) in the case of fungible goods, are of fair average quality within the description;

(c) are fit for the ordinary purposes for which goods of that description are used;

(d) run, within the variations permitted by the agreement, of even kind, quality and quantity within each unit and among all units involved;

(e) are adequately contained, packaged, and labeled as the agreement may require; and

(f) conform to the promise or affirmations of fact made on the container or label if any.

(3) Unless excluded or modified (Section 2-316) other implied warranties may arise from course of dealing or usage of trade.

2-315. Implied Warranty: Fitness for Particular Purpose.

Where the seller at the time of contracting has reason to know any particular purpose for which the goods are required and that the buyer is relying on the seller's skill or judgment to select or furnish suitable goods, there is unless excluded or modified under the next section an implied warranty that the goods shall be fit for such purpose.

2-316. Exclusion or Modification of Warranties.

(1) Words or conduct relevant to the creation of an express warranty and words or conduct tending to negate or limit warranty shall be construed wherever reasonable as consistent with each other; but subject to Section 2-202, negation or limitation is inoperative to the extent that such construction is unreasonable.

(2) Subject to subsection (3), to exclude or modify the implied warranty of merchantability or any part of it in a consumer contract the language must be in a record, be conspicuous, and state "The seller undertakes no responsibility for the quality of the goods except as otherwise provided in this contract," and in any other contract the language must mention merchantability and in case of a record must be conspicuous. Subject to subsection (3), to exclude or modify the implied warranty of fitness, the exclusion must be in a record and be conspicuous. Language to exclude all implied warranties of fitness in a consumer contract must state "The seller assumes no responsibility that the goods will be fit for any particular purpose for which you may be buying these goods, except as otherwise provided in the contract," and in any other contract the language is sufficient if it states, for example, that "There are no warranties that extend beyond the description on the face hereof." Language that satisfies the requirements of this subsection for the exclusion or modification of a warranty in a consumer contract also satisfies the requirements for any other contract.

(3) Notwithstanding subsection (2)

(a) unless the circumstances indicate otherwise, all implied warranties are excluded by expressions like "as is", "with all faults" or other language that in common understanding calls the buyer's attention to the exclusion of warranties, makes plain that there is no implied warranty, and, in a consumer contract evidenced by a record, is set forth conspicuously in the record;

(b) if the buyer before entering into the contract has examined the goods or the sample or model as fully as desired or has refused to examine the goods after a demand by the seller there is no implied warranty with regard to defects that an examination in the circumstances should have revealed to the buyer; and

(c) an implied warranty may also be excluded or modified by course of dealing or course of performance or usage of trade.

(4) Remedies for breach of warranty may be limited in accordance with Sections 2-718 and 2-719.

2-317. Cumulation and Conflict of Warranties Express or Implied.

Warranties whether express or implied shall be construed as consistent with each other and as cumulative, but if such construction is unreasonable the intention of the parties shall determine which warranty is dominant. In ascertaining that intention the following rules apply:

(a) Exact or technical specifications displace an inconsistent sample or model or general language of description.

(b) A sample from an existing bulk displaces inconsistent general language of description.

(c) Express warranties displace inconsistent implied warranties other than an implied warranty of fitness for a particular purpose.

2-318. Third Party Beneficiaries of Warranties Express or Implied.

(1) In this section:

(a) "Immediate buyer" means a buyer that enters into a contract with the seller.

(b) "Remote purchaser" means a person that buys or leases goods from an immediate buyer or other person in the normal chain of distribution.

Alternative A to subsection (2)

A seller's warranty to an immediate buyer, whether express or implied, a seller's remedial promise to an immediate buyer, or a seller's obligation to a remote purchaser under Section 2-313A or 2-313B extends to any individual who is in the family or household of the immediate buyer or the remote purchaser or who is a guest in the home of either if it is reasonable to expect that the person may use, consume, or be affected by the goods and who is injured in person by breach of the warranty, remedial promise, or obligation. A seller may not exclude or limit the operation of this section.

Alternative B to subsection (2)

A seller's warranty to an immediate buyer, whether express or implied, a seller's remedial promise to an immediate buyer, or a seller's obligation to a remote purchaser under Section 2-313A or 2-313B extends to any individual who may reasonably be expected to use, consume, or be affected by the goods and who is injured in person by breach of the warranty, remedial promise, or obligation. A seller may not exclude or limit the operation of this section.

Alternative C to subsection (2)

A seller's warranty to an immediate buyer, whether express or implied, a seller's remedial promise to an immediate buyer, or a seller's obligation to a remote purchaser under Section 2-313A or 2-313B extends to any person that may reasonably be expected to use, consume, or be affected by the goods and that is injured by breach of the warranty, remedial promise, or obligation. A seller may not exclude or limit the operation of this section with respect to injury to the person of an individual to whom the warranty, remedial promise, or obligation extends.

[2-319. Reserved]

[2-320. Reserved]

[2-321. Reserved]

[2-322. Reserved]

[2-323. Reserved]

[2-324. Reserved]

2-325. "Letter of Credit" Term; "Confirmed Credit".

If the parties agree that the primary method of payment will be by letter of credit, the following rules apply:

(a) The buyer's obligation to pay is suspended by seasonable delivery to the seller of a letter of credit issued or confirmed by a financing agency of good repute in which the issuer and any confirmer undertake to pay against presentation of documents that evidence delivery of the goods.

(b) Failure of a party seasonably to furnish a letter of credit as agreed is a breach of the contract for sale.

(c) If the letter of credit is dishonored or repudiated, the seller, on seasonable notification, may require payment directly from the buyer.

2-326. Sale on Approval and Sale or Return; Consignment Sales and Rights of Creditors.

(1) Unless otherwise agreed, if delivered goods may be returned by the buyer even if they conform to the contract, the transaction is:

(a) a "**sale on approval**" if the goods are delivered primarily for use; and

(b) a "**sale or return**" if the goods are delivered primarily for resale.

(2) Goods held on approval are not subject to the claims of the buyer's creditors until acceptance; goods held on sale or return are subject to such claims while in the buyer's possession.

(3) Any "or return" term of a contract for sale is to be treated as a separate contract for sale under Section 2-201 and as contradicting the sale aspect of the contract under Section 2-202.

2-327. Special Incidents of Sale on Approval and Sale or Return.

(1) Under a sale on approval unless otherwise agreed

(a) although the goods are identified to the contract the risk of loss and the title do not pass to the buyer until acceptance; and

(b) use of the goods consistent with the purpose of trial is not acceptance but failure seasonably to notify the seller of election to return the goods is acceptance, and if the goods conform to the contract acceptance of any part is acceptance of the whole; and

(c) after due notification of election to return, the return is at the seller's risk and expense but a merchant buyer must follow any reasonable instructions.

(2) Under a sale or return unless otherwise agreed

(a) the option to return extends to the whole or any commercial unit of the goods while in substantially their original condition, but must be exercised seasonably; and

(b) the return is at the buyer's risk and expense.

2-328. Sale by Auction.

(1) In a sale by auction, if goods are put up in lots each lot is the subject of a separate sale.

(2) A sale by auction is complete when the auctioneer so announces by the fall of the hammer or in other customary manner. If a bid is made during the process of completing the sale but before a prior bid is accepted, the auctioneer has discretion to reopen the bidding or to declare the goods sold under the prior bid.

(3) A sale by auction is subject to the seller's right to withdraw the goods unless at the time the goods are put up or during the course of the auction it is announced in express terms that the right to withdraw the goods is not reserved. In an auction in which the right to withdraw the goods is reserved, the auctioneer may withdraw the goods at any time until completion of the sale is announced by the auctioneer. In an auction in which the right to withdraw the goods is not reserved, after the auctioneer calls for bids on an article or lot, the article or lot may not be withdrawn unless no bid is made within a reasonable time. In either case a bidder may retract a bid until the auctioneer's announcement of completion of the sale, but a bidder's retraction does not revive any previous bid.

(4) If the auctioneer knowingly receives a bid on the seller's behalf or the seller makes or procures such a bid, and notice has not been given that liberty for such bidding is reserved, the buyer may at the buyer's option avoid the sale or take the goods at the price of the last good faith bid prior to the completion of the sale. This subsection shall not apply to any bid at an auction required by law.

PART 4. TITLE, CREDITORS AND GOOD FAITH PURCHASERS [Table of Contents]

2-401. Passing of Title; Reservation for Security; Limited Application of This Section.

Each provision of this Article with regard to the rights, obligations and remedies of the seller, the buyer, purchasers or other third parties applies irrespective of title to the goods except where the provision refers to such title. Insofar as situations are not covered by the other provisions of this Article and matters concerning title become material the following rules apply:

(1) Title to goods cannot pass under a contract for sale prior to their identification to the contract (Section 2-501), and unless otherwise explicitly agreed the buyer acquires by their identification a special property as limited by this Act. Any retention or reservation by the seller of the title (property) in goods shipped or delivered to the buyer is limited in effect to a reservation of a security interest. Subject to these provisions and to the provisions of Article 9, title to goods passes from the seller to the buyer in any manner and on any conditions explicitly agreed on by the parties.

(2) Unless otherwise explicitly agreed title passes to the buyer at the time and place at which the seller completes performance with reference to the physical delivery of the goods, despite any reservation of a security interest and even though a document of title is to be delivered at a different time or place; and in particular and despite any reservation of a security interest by the bill of lading

(a) if the contract requires or authorizes the seller to send the goods to the buyer but does not require the seller to deliver them at destination, title passes to the buyer at the time and place of shipment; but

(b) if the contract requires delivery at destination, title passes on tender there.

(3) Unless otherwise explicitly agreed where delivery is to be made without moving the goods,

(a) if the seller is to deliver a tangible document of title, title passes at the time when and the place where he delivers such documents and if the seller is to deliver an electronic docuemnt of title, title passes when the seller delivers the document; or

(b) if the goods are at the time of contracting already identified and no documents of title are to be delivered, title passes at the time and place of contracting.

(4) A rejection or other refusal by the buyer to receive or retain the goods, whether or not justified, or a justified revocation of acceptance revests title to the goods in the seller. Such revesting occurs by operation of law and is not a "sale".

Uniform Law Source: Uniform Commercial Code: Sections 2A-211; 2-312 (1998 Official Text).

Definitional Cross References. Section 102: "Agreement"; "Automated transaction"; "Conspicuous"; "Contract"; "Information"; "Informational rights"; "Knowledge;" "License"; "Licensee"; "Licensor"; "Merchant"; "Notify," "Person"; "Record"; "Scope"; "Term," "Transfer." Section 114: "Reason to know".

Official Comments:

1. *Scope of the Section.* This section deals with implied warranties relating to non-infringement, exclusivity, and enjoyment. These warranties cannot be disclaimed except as stated in this section.

2. *Non-Infringement Warranty.* Subsection (a) comes from Uniform Commercial Code Section 2-312 (1998 Official Text). When the information is part of the normal business subject matter of the licensor and is provided in the normal course of its business, it is the licensor's duty to see that no third party claim of infringement of an intellectual property right or of misappropriation will affect the delivered information. As in Article 2, a transfer by a person other than a dealer in information of the kind, raises no implication of such a warranty. .

a. Delivered Free of Infringement. Subsection (a) requires delivery free of rightful claim of infringement or misappropriation. The mere assertion of a claim does not breach this warranty; the clam must be valid. As in Uniform Commercial Code Section 2-312 (1998 Official Text), the warranty refers to circumstances and claims existing in reference to the information as it exists at the time of delivery. This warranty does not pertain to future events or uses, such as a subsequently issued patent; or infringement claims that result from a licensee's decision to use the

information with other information or property, the composite of which infringes a third party right; or a decision to use multi-functional software for an infringing use.

Chemtron, Inc. v. Aqua Products, Inc., 830 F. Supp. 314 (E.D. Va. 1993) and *Motorola v. Varo, Inc.*, 656 F.Supp. 716 (N.D. Tex. 1986) frame the issue correctly. The warranty does not cover future performance or uses in that performance which infringe unless these uses are the sole ones for which the information was designed. For example, in a license of a spreadsheet program, the warranty is that the program itself does not infringe another person's rights, not that uses of the program that involve employing is capability to be tailored to particular functions may not infringe another's rights.

See, e.g., *Matthew Bender & Co., Inc.. v. West Pub. Co.*, 158 F.3d 693 (2d Cir. 1998) (no infringement even if program and data could be used to recreate copyrighted work, when this was not the sole or necessary use). Under Section 805, the limitations period for breach begins when breach was or should have been discovered, rather than on delivery of the information.

b. Patent License. Subsection (c)(3) makes the subsection (a) warranty inapplicable to patent licenses. This refers to a party licensing a patent per se. Most such patent licenses are not within this Act, but in those cases where the license is within this Act, subsection (c) adopts the prevailing rule in patent licensing: a patent license does not warrant that the licensee can use the licensed technology, but merely affirms that the licensor will not sue for use of its rights. On the other hand, if a party licenses *software* , the subsection (a) warranty is breached if the software as delivered infringes a third party patent. If a licensor gives a licenses the *patent* itself, subsection (a) does not apply.

c. Specifications and Hold Harmless Duty. No warranty from the licensor is implied when the licensee orders computer information to be assembled, prepared, designed or manufactured on the licensee's detailed specifications and methods; in such cases liability runs from the licensee to the licensor. There is a tacit representation by the licensee that the licensor will be safe in following the detailed specifications and required method. *See Bonneau Co. v. AG Industries, inc.,* 116 F.3d 155 (5th Cir. 1997) (applying similar rule under Article 2).

The circumstances for this rule do not arise merely because the licensee assists and advises in developing the computer information and even suggests alternative approaches to development. In such cases, the licensor remains in control of developmental choices and has the duty to see that no claim of infringement will mar the licensee's interest. More generally, the licensee is entitled to rely on the technical expertise and judgments of the licensor, even when the parties are working together.

That entitlement is reversed only when the agreement makes clear that the licensee has undertaken to specify what must be done and how it must be done in detail sufficient to eliminate the licensor's choices. When this occurs, there is a tacit assurance from the licensee that there will be no infringement claim resulting from relying on that detailed contractual mandate. For this rule to apply, then, the specifications and method must be specific or detailed, rather than general, and compliance must be required by contract. The "hold harmless" obligation does not exist if infringement is caused by or arises out of optional choices of the licensor which may result in infringement.

This Act also clarifies that a licensor presented with specifications and required methods has an obligation to adopt, or notify the licensee of, non-infringing alternatives of which it has reason to know. The "hold harmless" obligation is eliminated if the licensor had reason to know of a non-infringing alternative and failed either to choose it or notify the licensee of it, such as when an experienced designer of banking systems knows that alteration of a specification would allow use of an alternative that will avoid infringement of a financial systems patent.

Only notice of a non-infringing alternative (if any) of which the licensor has reason to know is required; the section does not impose a duty of investigation and consequences of using the alternative must be handled under rules regarding amendments and the like, not this section. Reason to know for this purpose must exist at the time that the contract is performed. Since we are dealing with contractually required performance, however, it is enough that the licensee be notified of the non-infringing alternative - the licensor cannot unilaterally rewrite or ignore the contractual requirements.

d. Non-Infringement and Passive Transmission. The warranty in subsection (a) is only made by licensors of information. It does not apply to persons who merely provide communications or transmission services even if such service falls within this Act. Those service providers do not, for purpose of contract law, engage in activities that reasonably create the inference that they assure the absence of infringing information. That obligation could be expressly undertaken but is not created by this Act.

This Act takes no position and has no effect on federal questions about what constitutes infringement in such situations. Whether, a party is a "licensor of information" for contract law depends on its position with respect to affirmatively providing the information as part of its ordinary business. This issue has no bearing on whether a passive transmission provider is liable for infringement to the owner of intellectual property rights.

2. *Interference Warranty.* The warranty of quiet possession was abolished in Uniform Commercial Code Article 2 for sales of goods but reestablished in part as a warranty of non-interference in Uniform Commercial Code Article 2A for leases of goods. Paragraph (b)(1) follows Article 2A. It creates a warranty that no act or omission of the licensor will result in a third party holding a claim (other than infringement) that interferes with enjoyment by the licensee of it's contractual interest. "Enjoyment" refers to authorized exercise of contract rights in the use of the information.

The warranty is limited to interfering claims or interests that arise from the licensor's acts or omissions. As in Article 2A, this limitation enables the licensor to more adequately assess risks. Infringement and misappropriation claims are excluded from this subsection because they are dealt with in subsection (a). The warranty reflects that the nature of the limited interest in a license – the right to use the information or informational rights – results in a need of the licensee for protection greater than that afforded to a buyer of goods. The warranty is limited to rightful claims or interests that arise from acts or omissions of the licensor. The warranty represents a tacit commitment by the licensor that it will not act during the duration of the contract in a manner that detracts from the contractual grant.

3. *Exclusivity.* Subsection (b)(2) deals with exclusive licenses. When a license purports to be exclusive, it engenders two implied assurances that are not relevant for non-exclusive licenses. The first concerns the validity of the intellectual property rights. An exclusive licensor warrants that the rights conveyed are not in the public domain. If this condition is not met, the licensor cannot convey or the licensee receive truly exclusive rights. The second involves whether a portion of the rights covered by the license are vested in another person because co-authors or co-inventors were involved, or a prior license exists. In an exclusive license, the licensor implicitly warrants that this is not true. The reasoning on both points is similar: if the implied circumstances are not present, the meaning of "exclusivity" is altered. A similar concern does not exist for non-exclusive licenses because such a condition does not alter the licensee's ability to use the licensed rights as described.

A special rule governs patents, again reflecting practice in patent law. When the exclusivity warranty applies at all, it is restricted to the licensor's knowledge at the time of contracting. The warranty is inapplicable to patent licenses excluded under subsection (c)(3).

Exclusivity and validity are warranted only to the extent recognized in the law that applies to the rights in question. Thus, the licensor of a trade secret warrants that it has not granted rights to another person, but does not warrant that no other person independently holds the secret information. A trade secret gives no rights against independent discovery and, thus, the warranty does not purport to claim that no one else may use the secret information. Subsection (c)(1) reinforces this theme. If under applicable law, the rights are subject to compulsory licensing, public access or use, the warranty is limited by the terms of these rights. For example, a licensor of rights in information which must be licensed to any and all parties for a specified fee, does not warrant exclusivity. These off-setting rules, however, must be embodied in law.

4. *International Issues.* Intellectual property rights extend only within the territory of the jurisdiction that creates them, although some deference internationally occurs through multi-lateral treaties. Subsection (c)(2) similarly provides that implied exclusivity and infringement warranties extend only within this country and a country specifically mentioned in the warranty. This latter extension refers to statements made with express reference to the warranty, such as "Licensor warrants non-infringement worldwide." Other references in a license may not be intended to create a warranty. A grant of a license for worldwide use may be no more than a permission to use the information worldwide without risk of a lawsuit by the licensor, rather than a warranty that worldwide use will not infringe others rights. In the case of a "worldwide" warranty, the obligation extends only to countries that have intellectual property rights treaties with the United States. In the absence of such relationships, the rights created under United States law cannot create rights in the other country and, thus, it is assumed that the parties did not intend it to extend there.

5. *Disclaimer.* Subsection (d) derives from Uniform Commercial Code Article 2 (1998 Official Text). The infringement and other warranties in this section can be disclaimed. Under subsection (d), this requires specific language or circumstances indicating that the warranties are not given; illustrative language is provided for clarity. Subsection (d) limits the conditions under which the warranty can be disclaimed or modified; it does not limit or preclude disclaimer or modification of a hold harmless obligation that might arise under subsection (a).

Subsection (e) recognizes an alternative form of disclaimer in commercial cases. Reference to a grant of a "quitclaim" in this context is relatively common is some areas of business and indicates that the licensor is not undertaking any assurance about the nature or scope of the rights it holds or conveys.

2-402. Rights of Seller's Creditors Against Sold Goods.

(1) Except as provided in subsections (2) and (3), rights of unsecured creditors of the seller with respect to goods which have been identified to a contract for sale are subject to the buyer's rights to recover the goods under this Article (Sections 2-502 and 2-716).

(2) A creditor of the seller may treat a sale or an identification of goods to a contract for sale as void if as against him a retention of possession by the seller is fraudulent under any rule of law of the state where the goods are situated, except that retention of possession in good faith and current course of trade by a merchant-seller for a commercially reasonable time after a sale or identification is not fraudulent.

(3) Nothing in this Article shall be deemed to impair the rights of creditors of the seller

(a) under the provisions of the Article on Secured Transactions (Article 9); or

(b) where identification to the contract or delivery is made not in current course of trade but in satisfaction of or as security for a pre-existing claim for money, security or the like and is made under circumstances which under any rule of law of the state where the goods are situated would apart from this Article constitute the transaction a fraudulent transfer or voidable preference.

EXPRESS WARRANTY.

Uniform Law Source: Uniform Commercial Code: Section 2A-210; 2-313 (1998 Official Text).

Definitional Cross References. Section 102: "Aggrieved party"; "Agreement"; "Information"; "Informational content"; "Licensee"; "Licensor"; "Party"; "Person;" "Published informational content".

Official Comments:

1. *Scope and Basis of Section.* This section follows Article 2 of the Uniform Commercial Code (1998 Official Text) on express warranties, except with respect to published informational content, where it preserves current common law. "Express" warranties rest on "dickered" aspects of the individual bargain and go so clearly to the essence of that bargain that, as indicated in Section 406(a), words of disclaimer in a standard form cannot alter their terms. "Implied" warranties, on the other hand, rest on inferences from a common factual situation or set of conditions so that no particular language is necessary to create them. They exist unless disclaimed.

2. *Basis of the Bargain.* Subsection (a) generally adopts the "basis of the bargain" test used in Uniform Commercial Code §§ 2-313; 2A-210 (1998 Official Text). This allows courts and parties to draw on extensive case law distinguishing express warranties from puffing and from other unenforceable statements, representations or promises. The concept underlying the "basis of the bargain" standard is that express affirmations or promises are express warranties if they are within the matrix of elements that constitute and define the bargain of the parties, but that they are not express warranties if they are not part of the basis for the contract. This standard does not require that a licensee prove actual reliance on a specific statement in deciding to enter into the contract, but does require proof that the statement played a role in the bargain. This standard enables the creation of express obligations on the more general showing that statements about the information are part of and basic to the deal. The question is whether statements of the licensor made to the licensee have in the circumstances and in objective judgment become part of the basic deal. However, an express warranty concerns a bargains and this rule does not impose liability in contract for all statements a licensor makes about information, even if not brought to the attention of the licensee.

As in Article 2 of the Uniform Commercial Code (1998 Official Text), Section 402 deals with affirmations of fact, descriptions of information, exhibitions of samples, documentaton, and manuals in the same manner as any other part of the interaction that results in a contract. No specific intent to make a warranty is necessary if any of these are made part of the basis of the bargain. In actual practice, affirmations of fact describing the information and made by the licensor about it during the bargaining are ordinarily part of the bargain unless they are mere puffing, predictions, or otherwise not an enforceable commitment. No reliance on the specific statement need be shown in order to weave it into the fabric of the agreement. Rather, once made, to take such affirmations out of the agreement requires clear affirmative proof. If language is used after the closing of the deal (as when the licensee on taking delivery asks for and receives an additional assurance), the assurance may become a modification of the contract. An agreed modification requires no consideration to be binding. Section 303. Alternatively, under the layered contracting recognized in Article 2 and in this

Act, in appropriate cases the assurance may be treated as a further elaboration of the terms of the contract if the parties had reason to know this would occur. Section 208.

3. *Advertising as an Express Warranty.* Paragraph (a)(1) is new and is not found in Article 2. It clarifies that advertising by the licensor may create an express warranty if it otherwise meets the standards for an express warranty under this section. This expands the scope of express warranty law. However, a warranty exists only if the advertising statement becomes part of the bargain and a bargain actually occurs. The affirmation of fact in advertising must be known by the licensee, as well as influence and in fact become part of the basis of the bargain under which it acquired the computer information. If this does not occur, there is no express warranty. Also, many statements made in advertising are, of course, puffing or mere expressions of opinion and do not create an express warranty. In appropriate cases, there may be liability for false advertising, but that does not arise under contract law, but under tort or advertising law. This section does not create a false advertising claim under the guise of contract law.

4. *Descriptions.* Paragraph (a)(2) is a specific application of when a description becomes an express warranty. The description need not be by words. Technical specifications, blueprints and the like can afford more exact descriptions than mere language and, if made part of the basis of the bargain, become express warranties. Of course, all descriptions by merchants must be read against the applicable trade usage and in light of the concepts or general rules as to merchantability resolving any doubts about the meaning of the description. The description requires a commercially reasonable interpretation.

5. *Samples and Models.* Samples, models and demonstrations are treated no differently than statements. However, in mercantile experience, the mere exhibition of a "sample", a "model" or a "demonstration" does not of itself show whether it is intended to "suggest" or to "be" the character of the subject-matter of the contract. That distinction is recognized in reported cases and in this Act.

The effect of representations created by demonstrations and models must be gauged by what inferences would be communicated to a reasonable person in light of the nature of the demonstration, model, or sample. Showing a sample of a keg of raw beans consisting of cup-full of beans communicates one inference, while demonstration of a complex database program running ten files creates an entirely different inference if the intended use of the system is to process ten million files. This difference also applies to beta models of software which are used on a test or a demonstration basis and may contain elements that are not carried forward into the ultimate product. Ordinarily the parties understand that what is being demonstrated on a small scale or tested on a beta model is not necessarily representative of actual performance or of the eventual product. As with any other purported express warranty, any model or demonstration must be interpreted in a reasonable fashion that reflects the circumstances of the test or demonstration. The court's discussion in *NMP Corp. v. Parametric Technology Corp.*, 958 F. Supp. 1536 (S.D. Okla. 1997) is illustrative for software demonstrations.

6. *Puffing and Expressions of Opinion.* Subsection (b) makes it clear that puffing or mere statements of opinion do not form an express warranty. The law on the distinction between an actionable representation and puffing is extensive and well-developed. The distinction requires a determination based on the circumstances of the particular transaction. The policy that requires this distinction to be made reflects that in common experience some statements and predictions cannot fairly be viewed as entering into the bargain. To hold each party to every statement made would contradict common experience and stifle discourse about products and proposals. Of course, whether or not a statement is an express warranty does not affect whether the statement justify a remedy under the law of fraud or misrepresentation.

Paragraph (b)(2) identifies a common setting where the issue about how to treat a statement arises. It refers to statements or demonstrations pertaining to aesthetics and the appeal of informational as a form of puffing or opinion that does not create an express warranty. Aesthetics, as used here, refers to questions of the artistic character, tastefulness or beauty of the informational content, not to statements pertaining to how a person uses the informational content or its essential nature. For example, a statement that a clip art program contains useable images of "working people" may create an express warranty that the subject matter of the program includes working people and that the images are usable. Neither the statement, nor a selected display of part of the program which purports to show that they are tasteful or artistically pleasing creates an express warranty to that effect.

7. *Relation to Disclaimers.* Express warranty rules focus on determining what it is that the licensor agreed to provide. Descriptions of an information product, if made part of the bargain, are express warranties. If an express warranty is made, the obligations created ordinarily cannot be easily deleted. A general contract term disclaiming "all warranties, express or implied" is not given literal effect as to express warranties under Section 406(a). This does not mean that parties cannot make

their own bargain, including a bargain that does not include a purported express warranty. But, to do so requires that the particular description or promise not become part of the bargain. In determining what was the actual agreement, consideration should be given to the fact that the probability is small that a real price is intended to be exchanged for a pseudo-obligation. For example, a license of a "word-processing program" that contains a general disclaimer of all warranties is nevertheless a contract for an information product that satisfies the basic description of a "word-processing program."

8. *Published Informational Content.* Subsection (c) preserves current law for published informational content. This section does not change express warranty rules for published informational content, but does not preclude the imposition of any obligation under other law or the creation of an express contractual obligation. Despite it being law for over fifty years, no reported case law on published informational content uses Article 2 "basis of the bargain" standard. See Joel R. Wolfson, *Express Warranties and Published Informational Content under Article 2B: Does the Shoe Fit?,* 16 John Marshal Journal of Computer & Info. Law 384 (1997). Published informational content entails significant First Amendment interests and general public policies that favor encouraging public dissemination of information. Courts that deal with liability pertaining to published informational content must balance contract themes with these policies.

The cases deal with obligations for published informational content as questions of express contractual obligation, rather than warranty. For example, a promise to provide an electronic encyclopedia obligates the party to deliver that type of work, but that is simply a matter of defining the basic contractual promise. When focusing on the quality of the informational content under contract law, most courts conclude that the level of risk vis a vis published informational content and the potentially stifling effect that contract liability might have on the dissemination of speech encourage limiting or excluding liability. See *Daniel v. Dow Jones & Co., Inc.*, 520 N.Y.S.2d 334 (N.Y. City Ct. 1987). In some other cases, liability may arise under tort, such as in *Hansberry v. Hearst,* 81 Cal. Rptr. 519 (Cal. App. 1968). This section rejects the seemingly simple, but ultimately inappropriate step of merely adopting the basis of the bargain concept from sales of goods to this much different context. Where a contract obligation is breached with respect to published informational content in a transaction covered under this Act, remedies under this Act apply and replace remedies under the common law. This includes all provisions of Part 8 of this Act, including rule regarding the measure and exclusion of damages.

9. *Third Parties.* This section does not deal with the enforceability of representations made by remote parties and relied on by an ultimate user of information under tort law. Cases in tort pertaining to information do not parallel cases dealing with the manufacture and sale of goods. See, e.g., *Winter v. G.P. Putnam's Sons*, 938 F.2d 1033 (9th Cir. 1991). Information providers are liable to third parties in tort in only a few, atypical cases. This Act does not establish, expand or exclude such third party liability.

2-403. Power to Transfer; Good Faith Purchase of Goods; "Entrusting".

(1) A purchaser of goods acquires all title which his transferor had or had power to transfer except that a purchaser of a limited interest acquires rights only to the extent of the interest purchased. A person with voidable title has power to transfer a good title to a good faith purchaser for value. When goods have been delivered under a transaction of purchase the purchaser has such power even though

(a) the transferor was deceived as to the identity of the purchaser, or

(b) the delivery was in exchange for a check which is later dishonored, or

(c) it was agreed that the transaction was to be a "cash sale", or

(d) the delivery was procured through fraud punishable as larcenous under the criminal law.

(2) Any entrusting of possession of goods to a merchant that deals in goods of that kind gives him power to transfer all rights of the entruster to a buyer in ordinary course of business.

(3) "**Entrusting**" includes any delivery and any acquiescence in retention of possession regardless of any condition expressed between the parties to the delivery or acquiescence and regardless of whether the procurement of the entrusting or the possessor's disposition of the goods have been such as to be larcenous under the criminal law.

[*Note: If a state adopts the repealer of Article 6-Bulk Transfers (Alternative A), subsec. (4) should read as follows*:]

(4) The rights of other purchasers of goods and of lien creditors are governed by the Articles on Secured Transactions (Article 9) and Documents of Title (Article 7).

[*Note: If a state adopts Revised Article 6-Bulk Sales (Alternative B), subsec. (4) should read as follows*:]

(4) The rights of other purchasers of goods and of lien creditors are governed by the Articles on Secured Transactions (Article 9), Bulk Sales (Article 6) and Documents of Title (Article 7).

2-403 IMPLIED WARRANTY: MERCHANTABILITY OF COMPUTER PROGRAM.

Uniform Law Source: Uniform Commercial Code: Section 2-314; 2A-212 (1998 Official Text).

Definitional Cross References. Section 102: "Agreement"; "Computer program"; "Contract"; "Copies," "Delivery"; "Informational content"; "Licensor"; "Merchant".

Official Comments:

1. *Scope of the Section.* This section adapts the implied warranty of merchantability from Article 2 of the Uniform Commercial Code (1998 Official Text) to computer programs, even though under prior law, in many computer program transactions there are no implied warranties. Disclaimer or modification of the implied warranty is dealt with in Section 406. Obligations regarding informational content are described in Section 404.

2. *Background and Policy.* The implied warranty of merchantability comes from one of three different legal traditions associated with computer information transactions. **One**, the source of this warranty, is the Article 2 world of the sale of goods and focuses on the quality of the result (product) delivered, establishing an implied assurance that this quality will conform to ordinary standards for products of that type. The **second**, from common law dealing with licenses, services and information contracts, focuses on the process or performance effort, rather than the result, establishing standards such as that the work will be performed in a workmanlike manner. The **third**, from common law, pertains to services and information contracts in some states, rejecting any implied obligation in a contract other than one involving a special relationship of reliance.

This and the following two sections reflect the combined influence of these traditions, making distinctions between computer programs, on the one hand, and information or services, on the other. The implied merchantability warranty and the warranty in Section 404 pertaining to the accuracy of data may both apply to the same transaction and product. The one (merchantability) applies to the program and its functions, while the other (accuracy) applies to the data.

3. *Merchantability.* Merchantability sets out an implied obligation based on a measure of expectations about ordinary meanings and ordinary transactions in commerce. The warranty turns on the ordinary meaning of an agreement for the kind of computer program as recognized in the applicable business, trade or industry. As in the Uniform Commercial Code, the implied warranty is made only by all merchant-licensors..

a. Fit for Ordinary Purposes. In transactions with end users, under subsection (a)(1), the program must be fit for the ordinary purpose for which programs of that type are used. To be fit for ordinary purposes does not require that the program be the best or most fit for that use or that it be fit for all possible uses. To an extent greater than in sales of goods, computer programs are often adapted and employed in unlimited or inventive ways or ways that go well beyond the uses for which they were distributed. The focus is on the ordinary purposes for which such programs are used, not other purposes. Thus, use of ordinary, mass-market programs in the context of highly sensitive or commercial applications does not change the warranty into one that assures fitness for ordinary purposes of that sensitive use.

Merchantability does not require a perfect program, but the subject matter of the warranty must be generally within the average standards applicable in commerce for programs having the particular type of use. The presence of some defects may be consistent with the merchantability standard. Uniform Commercial Code § 2-314 (1998 Official Text) explains the concept in terms of "fair average," i.e., goods that center around the middle of a belt of quality – some may be better and some may be worse, but they cannot all be better and need not all be worse. That approach applies here. While perfection is an aspiration relevant in computer programs and goods, it is not a requirement of an implied warranty in either context.

In the late 1990's, a popular operating system program for small computers used by both consumers and commercial licensees contained over ten million lines of code or instructions. In the computer these instructions interact with each other and with code and operations of other programs. This contrasted with a commercial jet airliner that contained approximately six million parts, many of which involved no interactive function. Typical consumer goods contain fewer than one hundred parts and a typical book has fewer than one hundred fifty thousand words. It is virtually impossible to produce software of complexity that contains no errors in instructions that intermittently cause the program to malfunction, so-called "bugs." The presence of errors in is fully within common expectation – the question for merchantability is not whether there are errors but

whether given the errors the program still comes within the middle belt of quality, i.e., fit for the ordinary purposes for which such programs are used.

b. Distribution. If the transfer is to a person acquiring the program for re-distribution, the program must be honestly capable of re-distribution. Subsection (a)(2) sets outs two criteria under which this can be gauged - adequate packaging and even quality among multiple units. Consistent with the general concept these standards are judged in light of ordinary commercial expectations.

c. Labels. Subsection (a)(3) confirms that merchantability includes conformance to descriptions of fact contained on labels or containers. This is consistent with the function of this warranty, which is to give implied assurance that the product is generally the ordinary meaning of what is promised. The statements must be statements of fact, not mere puffing. In this aspect, the implied warranty arises from fact that will often also constitute an express warranty of description. Again, the meaning of any descriptive statement must be interpreted in light of the commercial context.

4. *Disclaimer.* As in Article 2 of the Uniform Commercial Code (1998 Official Text), the implied warranty of merchantability may be disclaimed as a matter of general contract law pursuant to the fundamental policy that the agreement of the parties controls. That principle is implemented in Section 406. The right to disclaim is central to the right of a party to determine what it agrees to sell or license and how the parties allocated commercial risks.

The law in some state prohibits disclaimer of implied warranties in consumer cases. This Act does not alter that law. Similarly, although one can disclaim all implied warranties under this Act and under Article 2, disclaimers are ordinarily not effective with respect to express warranties of description or otherwise.

5. *Informational Content, Aesthetics.* Merchantability does not apply to informational content, including the aesthetics of a product. This follows case law under the Uniform Commercial Code. Aesthetics, as used here, refers to questions of the artistic character, tastefulness, beauty or pleasing nature of informational content. These are matters of personal taste. On the other hand, merchantability, express warranty or other rules can be relevant to whether the computer program is what it purports it to be and is merchantable.

For example if a claim about images created by a program is that they are not attractive or well-executed, merchantability does not apply. If the complaint is that the commands contained in the program do not function properly and that thus the images are distorted, an issue of merchantability exists. A statement that a clip art program contains images of "horses" gives assurance that the subject matter of the program is horses does not purport to state that the images are tasteful or artistically pleasing or whether they are brown, white or green.

6. *Cause of Action for Breach.* As under other law, in a cause of action for breach of warranty it is necessary to show not only the existence of the warranty, but that the warranty was breached and that the breach was the proximate cause of the loss sustained. In such an action, e.g., in complex computer systems involving different hardware and software, that loss must be caused by defects in the computer program for which breach is claimed. Proof that losses were not so caused or were caused by events after the program was installed and unconnected to it, operate as a defense here as in other law.

2-404 IMPLIED WARRANTY: INFORMATIONAL CONTENT.

Uniform Law Source: Restatement (Second) of Torts 552.

Definitional Cross References. Section 102: "Informational content"; "Licensee"; "Merchant"; "Party"; "Published informational content".

Official Comments:

1. *Scope and Effect.* This section creates a new implied warranty. The warranty focuses on data conveyed in a relationship of reliance. It recognizes an implied assurance in such contracts that no data inaccuracies are caused by a failure of reasonable care.

2. *Accuracy.* This warranty is based on the expectation of a person receiving data in a special relationship of reliance that the data are not made inaccurate because of the provider's lack of reasonable care in performing the contract. This expectation cannot properly be understood to anticipate perfectly accurate data unless the agreement so indicates in its express terms. The warranty is limited to inaccuracies caused by a failure to use reasonable care. One who hires an expert cannot expect infallibility. Reasonable efforts, not perfect results, provide the appropriate standard in the absence of an express terms to the contrary. The discussion of the New York court in an analogous setting states the policy adopted here. *Milau Associates v. North Avenue Development Corp.,* 42 N.Y.2d 482, 398 N.Y.S.2d 882, 368 N.E.2d 1242 (N.Y. 1977).

What constitutes reasonable care depends on the commercial circumstances and the contracted for duties. For example, in a contract to transmit computer information, there is no duty to screen or vouch for accuracy, but merely to avoid a lack of reasonable care in the transmission that causes inaccuracies. On the other hand, a data provider involved in a context where major loss of human life is possible has a higher degree of care than a provider in other, less demanding settings.

a. Ordinary Standards as Described. Informational content is accurate if, within applicable understandings of permitted errors, it correctly portrays the objective facts to which it relates. Whether or not data are inaccurate so as to potentially breach this warranty is based on expectations gauged by ordinary standards of the relevant trade under the circumstances. In most large commercial databases, ordinary expectations assume that some data will be incorrect. Variations or error rates within the range of commercial expectations of the business, trade or industry do not breach the warranty. If greater accuracy is expected, that must be made express in the agreement. For example, if the normal expected error rate is twenty percent for a particular type of database, an error rate of fifteen percent does not create an inaccuracy within this section and does not breach the warranty. On the other hand, in other commercial contexts, greater of lesser error rates may be ordinarily expected.

The presence of an inaccuracy is also affected by what the data purport to be under the agreement. This section follows cases such as *Lockwood v. Standard & Poor's Corp.*, 175 Ill.2d 529, 689 N.E.2d 1140, 228 Ill.Dec. 719 (Ill. App. 1997). A contract to estimate the number of users of a product in Houston does not imply an obligation to provide an accurate count, but merely requires an estimate. That estimate, if honestly made does not breach this warranty.

b. Accuracy and Aesthetics. This warranty is not a warranty about the aesthetics, subjective quality, or marketability. These are subjective issues. Assurances on these issues require express agreement.

3. *Reliance Relationship.* In addition, the information must be provided by a merchant in a "special relationship of reliance" between the licensor and the licensee. If the absence of such relationship, the mere fact that one person contracts to provides information to another creates no implied obligation beyond good faith.

a. Reliance Relationships. The requirement of a special relationship of reliance is fundamental to the implied obligation and to balancing the interest of protecting client expectations while not imposing excessive liability risk on informational content providers in a way that might chill their information-providing activities. This stems in part from cases applying *Restatement (Second) of Torts* § 552. The special element of reliance comes from the relationship itself.

A relationship characterized by the provider's knowledge that the particular licensee plans to rely on the data in its own business and expects that the provider will tailor the information to its needs. The obligation arises only with respect to persons who possess unique or specialized expertise (a merchant) and who are in a special position of confidence and trust with the licensee such that reliance on the inaccurate information is justified and the party has a duty to act with care. See *Murphy v. Kuhn*, 90 N.Y.2d 266, 682 N.E.2d 972 (N.Y. 1997).

The relationship also requires that the provider make the information available as part of its own business in providing such information. The licensor must be in the business of providing that type of information. This adopts the rationale of cases holding that information provided as part of a differently focused commercial relationship, such as the sale or lease of goods, does not create protected expectations about accuracy except as might be created under express warranty law. The court in *A.T. Kearney v. IBM*, 73 F.3d 238 (9th Cir. 1997) describes many of the relevant issues. See also *Picker International, Inc. v. Mayo Foundation*, 6 F. Supp.2d 685 (N.D. Ohio 1998).

A fundamental aspect of a special reliance relationship is that the information provider is specifically aware of and personally tailors information to the needs of the licensee. A special relationship does not arise for information made generally available to a group in standardized form even if those who it subscribe to an information service that they believe is relevant to their commercial needs. The information must be personally tailored for the recipient. A special reliance relationship does not require a fiduciary relationship, but does require indicia of special reliance.

b. Published Informational Content. The implied warranty does not apply to published informational content. By definition, such content is information transferred other than in a reliance relationship. Published informational content is informational content made available to the public as a whole or to a range of subscribers on a standardized, not a personally tailored, basis. This includes a variety of commercially important general distribution or subscription services providing informational content such as an Internet web site listing information of local restaurants, their prices and their quality, as well as services that provide data about current stock or monetary exchange prices to subscribers.

Published informational content is the subject matter of general commerce in ideas, political, economic, entertainment or the like, whose distribution engages fundamental public policy interests in supporting and not chilling this distribution by creating liability risks. This Act addresses computer information product analogously to print newspapers or books which are not exposed to contractual liability risks based on mere inaccuracy; treating the new computer information products differently would reject the wisdom of prior law. Creating greater liability risk in contract would place an undue burden on the free flow of information. This policy underlies the result in *Cubby, Inc. v. CompuServ, Inc.*, 3 CCH Computer Cases 46,547 (S.D.N.Y. 1991) and *Daniel v. Dow Jones & Co., Inc.*, 520 N.Y.S.2d 334 (N.Y. City Ct. 1987).

4. *Conduits and Editing.* The implied warranty relates only to information provided by the licensor. Subsection (b) clarifies that there is no warranty with respect to third party content where the provider identifies the information as coming from a third party. The implied warranty also does not apply to parties engaged in editing informational content of another person. See *Doubleday & Co. v. Curtis*, 763 F.2d 495 (2d Cir.), cert. dismissed, 474 U.S. 912 (1985); *Windt v. Shepard's McGraw-Hill, Inc.*, 1997 WL 698182 (ED Pa. Nov. 5, 1997)

A person collecting, summarizing or transmitting the third party data as a conduit does not create the same expectations about performance as does a direct information provider. Whatever expectations arise focus on the third party. In these cases, however, the third party may not be contractually obligated to the licensee. Whether or not a contract exists, however, the conduit's obligation and the licensee's reasonable expectations with respect to it do not entail an obligation regarding the accuracy of the third party data. Concerning the policy issues in dealing with conduits, see *Zeran v. America On-Line, Inc.,* 129 F.3d 327 (4th Cir. 1997). On the related issue of tort liability for publishers who are not authors, see *Winter v. G.P. Putnam's Sons*, 938 F.2d 1033 (9th Cir. 1991) (describes policy interests that also support subsection (b)).

5. *Disclaimer.* This section creates a new warranty analogous to the theory of negligent misrepresentation. As in the common law, the obligation in this warranty may be disclaimed. Section 406 and see *Rosenstein v. Standard and Poor's Corp.*, 636 N.E.2d 898 (Ill. App. 1993). The warranty is that there are no inaccuracies in the information caused by a lack of care. Subsection (c) makes it clear that disclaimer of the warranty is not subject to the general rule that duties of reasonable care cannot be disclaimed. See Section 113(a)(1) of this Act. That general rule is inapplicable here: what is disclaimed is a warranty related to the accuracy of the content, not the exercise of reasonable care. No duty of reasonable care is created under this section.

2-405. IMPLIED WARRANTY: LICENSEE'S PURPOSE; SYSTEM INTEGRATION.

Uniform Law Source: Uniform Commercial Code: Sections 2-315; 2A-213 (1998 Official Text).

Definitional Cross References. Section 102: "Agreement"; "Computer program"; "Information"; "Informational content"; "Licensee"; "Licensor"; "Published informational content". Section 114: "Reason to know".

Official Comments:

1. *Scope of the Section.* Subsections (a) and (b) deal with cases where the expertise of the licensor is implicitly relied on by the licensee to achieve its purposes. They reconcile diverse case law. Subsection (c), imposes a new implied warranty.

2. *General Approach.* Subsection (a) applies where a licensor has reason to know of the licensee's particular purpose in the transaction and that the licensee is relying on the licensor's expertise in selecting or developing information suitable for that purpose. The subsection resolves a conflict in case law. Some cases, relying on the Uniform Commercial Code, apply a standard which creates an implied warranty that the product will be suitable to the purpose.

Others, treating a contract as services rather than a sale hold that no enhanced performance obligation exists unless there are express terms to that effect. This section uses the first standard in some cases but subsection (a)(2) applies a reasonable effort standard for cases where the relationship appears to concern services-like obligations. Under prior law, the decision was based on whether a court viewed the transaction as a sale (result) or services (effort) contract.

2. *Warranty of Fitness.* Subsection (a)(1) applies to cases analogous to transfers involving products and adopts a standard akin to Uniform Commercial code § 2-315 (1998 Official Text).. Whether or not this warranty arises is a question of fact determined by the circumstances at the time of contracting. A "particular purpose" differs from the ordinary purpose for which the information is used in that it envisages a specific use by the licensee peculiar to the nature of its business, while the ordinary purposes for which information products are used are under concept of merchantability. Normally, this warranty arises only if the licensor is a merchant with appropriate skill or judgment.

The warranty does not exist if there is no reliance in fact or if the particular purposes are not made known to the licensor. For this warranty to arise, the needs of the licensee must have been particularized and the licensor must implicitly undertake to fulfill them.

As in Article 2 of the Uniform Commercial Code, no express exclusion is made for cases where the information product is identified by a trade name. The designation of an item by a trade name, or indeed in any other definite manner, is only one of the facts to be considered on the question of whether the licensee actually relied on the licensor, but it is not of itself decisive of the issue. If the licensee insists on a particular brand, it is not relying on the licensor's skill or judgment –and no warranty arises. But the mere fact that the information has a trade name is not sufficient to indicate nonreliance if it has been recommended by the licensor as adequate for the licensee's purposes.

The warranty obligates the licensor to meet known licensee needs if the circumstances indicate that the licensee is relying on the provider's expertise. There are many development contract and other settings where no reliance exists, including where the licensee provides contract performance standards, rather than relying on the licensor. The express terms of the agreement may then require that the product meet the specifications, but no reliance exists on whether meeting the specifications meets the licensee's purposes.

3. *Services Warranty.* Subsection (a)(2) applies if the transaction more closely resembles services contracts and carries forward the type of implied obligation most appropriate to such cases. A skilled service provider does not guaranty a result suitable to the other party unless it expressly agrees to do so. *Milau Associates v. North Avenue Development Corp.,* 42 N.Y.2d 482, 398 N.Y.S.2d 882, 368 N.E.2d 1242 (N.Y. 1977). Subsection (a)(2) provides a standard to determine when a contract calls for services and effort, rather than result.

The test centers on whether the circumstances indicate that the service provider would be paid for time or effort, regardless of the fitness of the result. Such payment terms typify a services contract. Other factors in some cases may also indicate that the parties intended a services obligation as delineated in subsection (a)(2). What constitutes reasonable effort depends on the project involved and other circumstances of the relationship. *Micro Manager, Inc. v. Gregory*, 147 Wisc.2d 500, 434 N.W.2d 97 (Wisc. App. 1988). Subsection (d) makes it clear that this warranty, as well as the others in this section, may be disclaimed. See Comments to Section 404.

4. *Aesthetics and Published Information.* The warranty in subsection (a) does not apply to aesthetics and the like. Subsection (b) nevertheless repeats a theme of the Act, which is that implied warranties do not apply to the aesthetics of information or to published informational content. Aesthetics refers to the artistic character, tastefulness, beauty or pleasing nature of informational content. These are matters of personal taste, rather than elements susceptible to implied warranty. On the other hand, warranty standards are appropriately addressed to whether the information is what its description purports it to be and whether it is useable by the transferee.

5. *System Integration.* Subsection (c) creates a new implied warranty regarding system performance in cases of systems integration contracts. The warranty is that the selected components will function as a system. This does not mean that the system, other than as stated in subsection (a), will meet the licensee's purposes, that it is an optimal system, or that it will not infringe third party rights – the warranty is merely that the system will functionally operate as a system. Thus, if the agreement requires the licensor to select a computer, printer and 5 software applications, the warranty is that all 5 applications will run on the computer selected and that the printer will work with the computer and the software. Whether these components were the best choice or will meet the actual needs of the licensee is not within these subsection (c) warranty. Other warranties can operate additionally to this warranty.

2-406. DISCLAIMER OR MODIFICATION OF WARRANTY.

Uniform Law Source: Uniform Commercial Code: Section 2A-214 (1998 Official Text).

Definitional Cross References. Section 102: "Computer program"; "Conspicuous"; "Contract"; "Course of Dealing"; "Course of Performance;" "Information"; "Licensee"; "Licensor"; "Mass-market license"; "Record"; "Usage of Trade."

Official Comments:

1. *General Structure and Policy.* This section deals with disclaimer of warranties, except statutory warranties which may only be disclaimed under Section 401. The section generally corresponds to Article 2 and Article 2A of the Uniform Commercial Code (1998 Official Text). Those statutes refer to "negating" or "limiting" warranties while this Act, reflecting modern terminology, speaks of "disclaiming" or "modifying" warranties; no substantive difference is intended. This Act does not alter consumer protection statutes that in some states preclude disclaimer of implied warranties in consumer cases. Section 105. The section follows fundamental U.S. law which recognize that implied

warranties are default rules and parties may disclaim or limit them to control what risk each undertakes.

2. *Express Warranties.* General language of disclaimer cannot exclude express warranties. While courts should construe contract terms of disclaimer and language of express warranty as consistent whenever reasonable, in cases of inconsistency, express warranty language controls. While, in effect, an express warranty cannot be disclaimed, a representation that might otherwise be an express warranty can be excluded from the bargain.

The agreement controls. For example, language of the agreement, including language styled as a disclaimer, may indicate that a purported warranty did not in fact become part of the bargain and is not, therefore, an express warranty. This may occur when the precise language of the agreement contradicts the alleged express warranty or where the agreement expressly precludes reliance on representations outside the authenticated record.

While express warranties survive general disclaimers, as in Article 2, the licensor is protected against unfounded claims of oral express warranties by the provisions of this Act on parol or extrinsic evidence and by the other terms of its contract. It is protected against unauthorized representations by agency law. Remedies for breach of warranty are dealt with in other sections of this Act and may be modified in accordance with this Act.

3. *Disclaimers and Fraud.* This Act does not alter the law of fraud. If the licensor makes an intentional misrepresentation of an existing material fact on which the licensee reasonably relied, it may be liable for fraud even though a disclaimer may eliminate contractual warranty liability. A failure to disclose known material problems in a product being provided pursuant to a license may constitute fraud if an obligation to disclose exists under law. *See e.g., Strand v. Librascope, Inc.,* 197 F. Supp. 743 (E.D. Mich. 1961). While general disclaimers do not foreclose liability for intentional fraud in most states, disclaimers specific to particular facts may foreclose a claim in fraud by eliminating the element of fraud that requires reasonable reliance on a material misrepresentation.

4. *Disclaimer of Implied Warranties.* Subsection (b) states particular rules for disclaimer of implied warranties. These are subject to subsections (c), (d) and (e). The purpose of the disclaimer rules is to provide a means in which the parties can clearly achieve their intended result in either disclaiming or not disclaiming a warranty, and which means also assures that the party against which the disclaimer operates has fair notice of its terms.

a. When a Record is Required. This Act follows Uniform Commercial Code § 2-316 (1998 Official Text) in providing that disclaimer of implied warranties of merchantability (Section 403) or accuracy (Section 404) need not be in a record. Disclaimer of the "fitness" warranty and the general language for disclaiming all implied warranties in subsection (b)(3), however, must be contained in a record.

b. Merchantability and Accuracy. Except as indicated in paragraphs (b)(3) and (b)(4), under subsection (b)(1), to disclaim the warranty of merchantability or accuracy, a disclaimer is sufficient if it mentions merchantability, accuracy, or uses words of similar import and, if a record is used for the disclaimer, the language must be conspicuous. These rules follow Uniform Commercial Code § 2-316 (1998 Official Text). Use of "quality" is allowed for the merchantability warranty, but not required. Alternative words must reasonably achieve the purpose of clearly indicating that the warranty is not given. The rules here, however, are subject to the general disclaimer language in subsection (b)(3) and to the other rules of subsection (c), (d) and (e).

c. Fitness Warranty; Systems Integration Warranty. Except as indicated in paragraphs (b)(3) and (b)(4), subsection (b)(2) provides language adequate to disclaim the warranties under Section 405. The specific language is not mandatory but must be in a record and be conspicuous. This applies the rule in Article 2 of the Uniform Commercial Code for the "fitness" warranty to both this Act's "fitness" warranty and its new systems integration warranty.

d. Disclaimer of All Warranties. Subsection (b)(3) recognizes that in some cases all implied warranties are disclaimed. The subsection sets out language that is sufficient for this purpose. This general disclaimer language must be in a record and be conspicuous so as to assure fair notice of its terms.

e. Article 2 and 2A Disclaimers. Subsection (b)(4) provides for cross-statute validity of disclaimer language that will avoid traps for parties in contracts involving mixed subject matter. The intent is to avoid requiring parties to make a priori determinations about which law governs. Language adequate to disclaim a warranty under one of these statutes is adequate to disclaim the equivalent warranty under this Act.

5. *Disclaimers of Implied Warranties By Circumstances.* Subsections (c), (d) and (e) deal with situations in which the circumstances surrounding the transaction are in themselves sufficient to call

the licensee's attention to the fact that an implied warranty is not made or is excluded. These methods of exclusion apply only to implied warranties. They do not exclude express warranties.

a. "As is" Disclaimers. Terms such as "as is" and "with all faults" in ordinary commercial usage are understood to mean that the transferee takes the entire risk as to the quality of the information involved. Typically, such expressions are not accompanied by extensive express warranties. As under Uniform Commercial Code Article 2, recognition of the effectiveness of these terms here is a specific application of rule in subsection (e) which provides that implied warranties for exclusion of modification of implied warranties by usage of trade. The terms also accommodate electronic commerce which may require "short" or summary terms because of limited space in records or displays. The language need not be in a record.

b. Inspection. Subsection (d) follows Uniform Commercial Code Article 2 (1998 Official Text). Implied warranties may be excluded or modified where the licensee examines the information or a sample or model of it before entering into the contract. The examination or opportunity to do so must occur before the contract is made. Thus, "examination" is not synonymous with inspection before acceptance of information tendered pursuant to a contract or inspected at other time after the contract has been made. It goes to the nature of the responsibility assumed by the licensor in making the contract. If the buyer discovers a defect and goes ahead to make the contract, or if it unreasonably fails to examine the information before making the contract, there is no basis to imply the existence of a warranty on a subject which examination did or should have reveals.

In the event the contract is made, the resulting damages may be found to result from the licensee's own action rather than from a breach of warranty. For a transaction to be within the scope of subsection (d), it is not sufficient that the information merely be available for inspection. There must be a demand or offer by the licensor that the licensee examine the information.

This puts the licensee on notice that it is assuming the risk of defects which the examination ought to reveal. On the other hand, this result can be altered by statements made by the licensor at the time. Thus, if the offer of examination is accompanied by words giving assurance about their merchantability or about specific attributes and the buyer indicates clearly that it is relying on those words rather than on an examination, the words may give create an "express" warranty. In such case, disclaimer of an express warranty is governed by subsection (a).

The licensee's skill and the normal method of examining information in the circumstances determine what defects are excluded by the examination. A failure to notice defects which are obvious cannot excuse the licensee. However, an examination made under circumstances which do not permit extensive testing would not exclude defects that could be ascertained only by such testing. Nor can latent defects be excluded by a simple examination. A merchant licensee examining a product in its own field is held to have assumed the risk as to all defects which a merchant in the field ought to observe, while a non-merchant licensee is held to have assumed the risk only for such defects as an ordinary person might be expected to observe.

c. Course of Dealing, etc. Subsection (e) follows Uniform Commercial Code § 2-316(3)(c) (1998 Official Text). It permits disclaimer of implied warranties by course of performance, course of dealing or usage of trade. It is consistent with the general concept of practical construction of contracts established under Article 2 and followed in this Act.

d. Detailed Specifications. As in Article 2, if a licensee gives precise and complete specifications for an informational product, implied performance warranties may be excluded. The warranty of fitness will not normally apply because there is no reliance on the licensor. The warranty of merchantability in such a transaction must be considered in connection with Section 408 which, as in Article 2, provides that express warranties displace inconsistent implied warranties. If the licensee gives detailed specification as to the information or program, neither the implied warranty of fitness nor the implied warranty of merchantability normally will apply.

2-407. MODIFICATION OF COMPUTER PROGRAM.

Definitional Cross References. Section 102: "Computer program"; "Copy"; "Licensee".

Official Comments:

1. *Scope of Section.* This section deals with the effect of modifications by the licensee to computer programs of than changes made using an aspect of the program intended for that purpose. The changes eliminate any performance warranty with respect to the modified copy. The rule applies only to a modified copy. If the defect existed in the unmodified copy, modifications have no effect. Also, the warranty only relates to performance -- it does not apply to title and non-infringement warranties.

2. *Policy Basis.* The complexity of computer programs means that even small changes may cause unanticipated and uncertain results. Also, it often is not possible to prove to what extent a change in one aspect of a program altered its performance as to other aspects.

3. *Application.* The section covers cases where the licensee makes changes that are not part of the program options. If a user employs a menu of options to tailor a computer program to the user's needs, this section does not apply. However, if the user modifies code in a way not intended by program options, modification eliminates performance warranties as to the altered copy.

This section does not apply where the parties jointly develop a program, with each authorized to change code created by the other. Who is the licensor in such cases is not clear, but the joint project takes the case out of this section. What warranties arise is determined by who the licensor is and by the agreement of the parties, which is construed in light of the circumstances of the transaction.

2-408. CUMULATION AND CONFLICT OF WARRANTIES.

Uniform Law Source: Uniform Commercial Code § 2-317 (1998 Official Text).

Definitional Cross References. Section 1-102: "Party".

Official Comments:

1. *Scope of Section.* This section deals with the inter-relationship of various types of warranties. The section follows Article 2 of the Uniform Commercial Code (1998 Official Text).

2. *Cumulative Warranties.* The basic premise of this section rests on the policy of this Act that no warranty is created except by some conduct by the licensor. Therefore, the presumption is that all warranties are cumulative unless this construction of the contract is impossible or unreasonable, or the terms of the agreement indicate otherwise.

3. *Inconsistent Warranties.* Paragraphs (1), (2) and (3) derive from Article 2 and deal with interpretive rules applicable to determining the intent of the parties as to which of several inconsistent potential sources of warranties that have arisen from the circumstances of the transaction prevail. These rules do not displace concepts of equitable estoppel, but apply where the licensor has in good faith engaged in conduct or made representations that might establish warranties but which later turn out to be inconsistent. To the extent that the seller led the buyer to believe that all the inconsistent warranties can be performed, the licensor may be estopped from setting up any inconsistency as a defense.

The rules in paragraphs (1), (2) and (3) are designed to ascertain the intent of the parties by reference to the factor which probably claimed the attention of the parties in the first instance. Thus, express warranties displace inconsistent implied warranties and exact technical specifications displace the import of an inconsistent sample. In both cases, the more specific or explicit terms are presumed to be the dominant factors defining the agreement. These rules are not absolute but may be changed by evidence showing that conditions at the time of contracting make that construction inconsistent with the agreement or unreasonable in light of it.

2-409 THIRD-PARTY BENEFICIARIES OF WARRANTY Uniform Law Source: Restatement (Second) of Torts 552.

Definitional Cross References. Section 102: "Consumer"; "Consumer contract"; "Contract"; "Information"; "Licensee"; "Licensor"; "Party"; "Person"; "Published informational content"; "Term".

Official Comments:

1. *Scope of the Section.* This section adopts third-party beneficiary concepts based on the contract law theory of "intended beneficiary" and *Restatement (Second) of Torts* § 552 dealing with the liability to third parties for a provider of information. It expands both as to uses within the licensee's household.

2. *Liability to Third Parties.* Liability is restricted to intended third parties and those in a special relationship with the information provider. Intent requires more than that the person be within a general category of those who may use the information (.e.g., all readers). There must be a closer and more clearly known connection to a particular third party. The liability covers use in transactions that the licensor intended to influence and does not include liability for published informational content.

Illustration: Licensor contracts for publication of an electronic text on chemical interactions. Publisher obtains an express warranty that Licensor exercised reasonable care in researching. Publisher distributes the text to the general public. Some data are incorrect. Neither Publisher (which makes no warranty for published informational content), nor Licensor (who did not evidence that it intended the warranty of reasonable care to run to anyone other than the Publisher)) makes a warranty to a general buyer of the book.

Dealing with informational content, the California Supreme Court in *Bily v. Arthur Young & Co.*, 3 Cal.4th 370, 11 Cal. Rptr. 2d 51, 834 P2d 745 (1992), commented:

By confining what might otherwise be unlimited liability to those persons whom the engagement is designed to benefit, the Restatement rule requires that the supplier of information have notice of potential third party claims, thereby allowing it to ascertain the potential scope of its liability and make rational decisions regarding the undertaking.

To impose liability under contract law, the information provider must have known of and clearly intended to have an effect on third parties. This requires a conscious assumption of risk or responsibility for particular third parties. Even then, courts should not aggressively find the requisite intent.

Information has a unique role in our culture. It is also uniquely difficult to show or disprove a causal connection between a release of informational content and harmful effects to third parties. This section reflects sensitivity to the risk that placing excessive liability exposure on information providers without their express undertaking may chill the dissemination of information.

3. *Product Liability Law.* This section does not deal with products liability or other tort issues. It neither expands nor restricts tort concepts that might apply for third party risk, leaving development or non-development of any appropriate liability doctrine to common law courts. Indeed, few courts impose third party tort liability in transactions involving information. The *Restatement (Third) on Products Liability,* recognizing this, notes that informational content is not a product for that law.

The only reported cases that impose product liability on information involve air flight charts. The cases analogized the technical charts to a compass or similar, physical instrument. These cases have not been followed in other contexts. Most courts specifically decline to treat information content as a product, including the Ninth Circuit, which decided two of the air flight chart cases, but later commented that public policy accepts the idea that information once placed in public moves freely and that the originator does not owe obligations to those remote parties who obtain it. *Winter v. G. P. Putnam's Sons,* 938 F.2d 1033 (9th Cir. 1991); *Berkert v. Petrol Plus of Naugatuck*, 216 Conn. 65, 579 A.2d 26 (Conn. 1990).

As in transactions in goods, there may be a tension between the use of the idea of merchantability in this Act and its role in product liability law. The primary source of that tension arises from disagreement about whether the concept of defect in tort and the concept of merchantability in contract law are coextensive where personal injuries are involved, i.e. if a product is merchantable under warranty law can it still be defective under tort law and if a product is not defective under tort law can it be unmerchantable under warranty law?

The answer to both questions should be no, and any tension between merchantability in warranty and defect in tort where personal injuries are involved should be resolved as follows: (1) when recovery is sought for injury to person or property, whether goods are merchantable is to be determined by applicable state products liability law; and (2) when however, a claim for injury to person or property is based on an implied warranty of fitness or an express warranty, this Act determines whether an implied warranty of fitness or an express warranty was made and breached, as well as what damages are recoverable under this Act.

4. *Household and Family Use.* Subsection (b) modifies intended beneficiary concepts to per se include the family of an individual, consumer licensee. This covers both personal injury and economic losses and applies to consumer use by the indicated persons. To apply, the use by the family members must be authorized under the license and the licensee must be an individual (a human being), not a corporation. The section assumes that the licensor had some reason to anticipate that the information would be used in the licensee's household. If a household member uses a commercial data compression system licensed to a professional, this section does not create or extend any warranties to that household member because the predicate warranty was not a warranty to a consumer. On the other hand, a licensor of mass-market word processing software might reasonably expect acquisition of it by a consumer for use at home.

5. *Limitation by Contract.* Subsections (c) and (d) reflect that the basis of this section lies in beneficiary status, rather than product liability. A disclaimer or a statement excluding intent to affect third parties excludes liability under this section. This follows current law. See, e.g., *Rosenstein v. Standard and Poor's Corp.*, 636 N.E.2d 898 (Ill. App. 1993).

PART 5. PERFORMANCE [Table of Contents]

2-501. Insurable Interest in Goods; Manner of Identification of Goods.

(1) The buyer obtains a special property and an insurable interest in goods by identification of existing goods as goods to which the contract refers even though the goods so identified are non-conforming and he has an option to return or reject them. Such identification can be made at any time and in any manner explicitly agreed to by the parties. In the absence of explicit agreement identification occurs

(a) when the contract is made if it is for the sale of goods already existing and identified;

(b) if the contract is for the sale of future goods other than those described in paragraph (c), when goods are shipped, marked or otherwise designated by the seller as goods to which the contract refers;

(c) when the crops are planted or otherwise become growing crops or the young are conceived if the contract is for the sale of unborn young to be born within twelve months after contracting or for the sale of crops to be harvested within twelve months or the next normal harvest reason after contracting whichever is longer.

(2) The seller retains an insurable interest in goods so long as title to or any security interest in the goods remains in him and where the identification is by the seller alone he may until default or insolvency or notification to the buyer that the identification is final substitute other goods for those identified.

(3) Nothing in this section impairs any insurable interest recognized under any other statute or rule of law.

OWNERSHIP OF INFORMATIONAL RIGHTS.

Definitional Cross References. Section 102: "Agreement"; "Contract"; "Copy"; "Information"; "Informational rights"' "Transfer."

Official Comments:

1. *Scope of the Section.* This section deals with transfers of ownership of intellectual property rights, not transfers of title to a copy.

2. *Copy vs. Rights Ownership.* Title to a copy is distinguished from ownership of intellectual property rights. This distinction is fundamental in intellectual property law and made explicit in the federal Copyright Act and other law. It is acknowledged in subsection (b). While obtaining ownership of a copy may give the copy owner some rights with respect to that copy, it does not convey ownership of the underlying intellectual property rights in a work of authorship, a patented invention or other intellectual property. The media that constitutes the copy is merely a conduit for use, but not ownership, of rights.

3. *Rights Ownership.* Subsection (a) deals with when and where ownership of informational rights transfers as a matter of state law. The section is confined to cases where there is an intent to transfer ownership of informational rights (as compared to a license to use such rights or an intent to merely transfer title to a copy). If federal law requires a writing for a transfer of ownership, state law is subject to that rule and subsection (a) should be read as conditional on compliance with such federal law requirement. Section 105. Similarly, while most copyright works for hire are not within this Act, if copyright law doctrines regarding a work for hire apply, they control over this section to the extent of any inconsistency.

The agreement controls when and where ownership of rights passes to the other party. The agreement may be found in express terms of the contract or usage of trade, course of dealing, or the circumstances of the particular transaction. In the absence of terms of agreement, under this section, transfer of ownership of informational rights does not hinge on delivery of a copy. It occurs when the information and the rights come into existence and are identified to the contract. The subsection thus reverses *In re Amica,* 135 Bankr. 534 (Bankr. N.D. Ill. 1992) to the extent that it stands for the proposition that ownership cannot pass until actual delivery of the completed work.

Identification requires both completion to a sufficient level to separate the information from other information of the transferor and an indication by the transferor that the particular information is that which will be transferred under the contract. *In re Bedford Computer,* 62 Bankr. 555 (D.N.H. 1986) provides guidance on the relevant issues. The term "identification to the contract" is used in Article 2 of the Uniform Commercial Code and should be interpreted in light of that use.

Early drafts or working copies are ordinarily not "identified" to a contract that provides for a transfer of ownership of rights in a completed product or program because in that case the interim drafts and working copies are not intended for the licensee in fulfillment of the contract. However, the agreement controls. If the agreement is that the licensee will own work in progress and working drafts, then by agreement those are the contractual subject matter. They are identified to the contract when created where creating the work in progress is connected to the contract.

While identification to the contract controls in the absence of contrary agreement, the agreement ultimately controls. In many cases, an agreement provides that ownership does not vest in the transferee until it performs all of its obligations. In such cases, a material failure to perform an obligation such as to pay or provide other consideration due precludes transfer of ownership until the obligations are met. If payment or other consideration is deferred under the agreement until after

ownership clearly vests, of course, a court may conclude that receipt of that consideration was not a condition precedent to the transfer of title.

2-502. Buyer's Right to Goods on Seller's Repudiation, Failure to Deliver or Insolvency.

(1) Subject to subsections (2) and (3) and even though the goods have not been shipped a buyer who has paid a part or all of the price of goods in which he has a special property under the provisions of the immediately preceding section may on making and keeping good a tender of any unpaid portion of their price recover them from the seller if:

(a) in the case of goods bought for personal, family, or household purposes, the seller repudiates or fails to deliver as required by the contract; or

(b) in other cases, the seller becomes insolvent within ten days after receipt of the first installment on their price.

(2) The buyer's right to recover the goods under subsection (1)(a) vests upon acquisition of a special property, even if the seller had not then repudiated or failed to deliver.

(3) If the identification creating his special property has been made by the buyer he acquires the right to recover the goods only if they conform to the contract for sale.

Uniform Law Source: Section 2-401; Section 2A-302 (1998 Official Text). Revised.

Definitional Cross References. Section 102: "Agreement"; "Contract"; "Copy"; "Delivery"; "Electronic"; "Information"; "Informational rights"; "License"; "Licensee"; "Licensor"; "Party"; "Sale"; "Transfer".

Comments:

1. *Scope of the Section.* This section deals with transfers of title to or ownership of a copy.

2. *Ownership of a Copy.* Subsection (a) applies only to licenses. The basic rule is that, if there was no intent to transfer title of a copy, title to that copy remains in the transferor. In this Act, however, title to the copy has only limited significance. Thus, subsection (a)(2) notes that the ability of a licensee to possess or control a copy does not depend "solely" on title to it – obviously, the agreement of the parties is the most relevant source.

a. Copy Ownership. In a license, who has title to the copy depends on the terms of the license. As in Uniform Commercial Code Article 2A (1998 Official Text), this Act does not presume that a transfer of title occurs on delivery. The agreement controls. If the license is silent, determination of whether there was an intent to transfer title to the copy to the licensee may require consideration of the entire terms and context of the transaction. In general, title does not vest in the licensee if the license places restrictions on use of the information on that copy that are inconsistent with ownership of the copy. *DSC Communications Corp. v. Pulse Communications, Inc.*, 170 F.3d 1354 (Fed. Cir. 1999).

b. Right to Possession. Paragraph (a)(2) clarifies that the license governs rights to possession or control of a copy and that those rights do not depend solely on who has title to the copy. This corresponds to ordinary commercial expectations and is an application of the basic principle that the agreement controls, rather than any formal placement of title.

c. Effect of Reservation of Title. Under paragraph (a)(3), reservation of title to a copy in a license implies a reservation of title in all copies of it made by the licensee. That default rule is altered if the transaction contemplates that the licensee will make copies for sale or other distribution. Thus, a license of a manuscript to a publisher contemplating production and distribution of the manuscript as computer information, reserves title only to the delivered copy and not to the digital copies produced by the publisher. On the other hand, this concept does not apply where the expectation is that the licensee will transfer copies to others subject to a license mandated by the licensor. In that case, distribution is contemplated, but under license and not transfer of title to copies. In any case, of course, the agreement controls and express terms on this issue displace the default rule in paragraph (a)(3).

3. *When Title to a Copy Passes.* Subsection (b) deals only with contracts where the parties agree to transfer title to a copy. The subsection states presumptions relating to when such title passes, but the general rule is that the terms of the contract control. In the absence of agreed terms, this section distinguishes between physical and electronic transfers. The rule for physical transfers of a tangible copy parallels Uniform Commercial Code Article 2 (1998 Official Text).

Title transfers when the licensor completes its obligations regarding tender of delivery, which obligations are spelled out in Section 606. The rule for electronic transfers is the same, but explicitly defers to federal copyright law. Some argue that even if there is an intent to transfer title to a copy, an electronic transfer of a copy of a copyrighted work is not a first sale because it does not involve

transfer of a copy from the licensor to the licensee. Under subsection (b), state law expressly coordinates with resolution of that issue in federal law. This Act takes a neutral position.

2-503. Manner of Seller's Tender of Delivery.

(1) Tender of delivery requires that the seller put and hold conforming goods at the buyer's disposition and give the buyer any notification reasonably necessary to enable him to take delivery. The manner, time and place for tender are determined by the agreement and this Article, and in particular

(a) tender must be at a reasonable hour, and if it is of goods they must be kept available for the period reasonably necessary to enable the buyer to take possession; but

(b) unless otherwise agreed the buyer must furnish facilities reasonably suited to the receipt of the goods.

(2) Where the case is within the next section respecting shipment tender requires that the seller comply with its provisions.

(3) Where the seller is required to deliver at a particular destination tender requires that he comply with subsection (1) and also in any appropriate case tender documents as described in subsections (4) and (5) of this section.

(4) Where goods are in the possession of a bailee and are to be delivered without being moved

(a) tender requires that the seller either tender a negotiable document of title covering such goods or procure acknowledgment by the bailee of the buyer's right to possession of the goods; but

(b) tender to the buyer of a non-negotiable document of title or of a record directing the bailee to deliver is sufficient tender unless the buyer seasonably objects, and except as otherwise provided in Article 9 receipt by the bailee of notification of the buyer's rights fixes those rights as against the bailee and all third persons; but risk of loss of the goods and of any failure by the bailee to honor the non-negotiable document of title or to obey the direction remains on the seller until the buyer has had a reasonable time to present the document or direction, and a refusal by the bailee to honor the document or to obey the direction defeats the tender.

(5) Where the contract requires the seller to deliver documents

(a) he must tender all such documents in correct form, except as provided in this Article with respect to bills of lading in a set (subsection (2) of Section 2-323); and

(b) tender through customary banking channels is sufficient and dishonor of a draft accompanying or associated with the documents constitutes non-acceptance or rejection.

TRANSFER OF CONTRACTUAL INTEREST

Uniform Law Source: Uniform Commercial Code: Section 2-210; Section 2A-303 (1998 Official Text). Restatement (Second) of Contracts § 317.

Definitional Cross References. Section 102: "Agreement"; "Contract"; "Copy"; "Information"; "Informational rights"; "License"; "Licensee"; "Licensor"; "Term"; "Transfer".

Official Comments:

1. *Scope of the Section.* This section deals with transfers of contractual interests. It concerns both transferability when the agreement is silent and the effect of a term prohibiting or limiting transfer.

2. *Transfer of Contract.* The term "transfer" when used with respect to a contractual interest refers to what in many contexts is described as an "assignment of a contract." Section 102. The term as used in this Act does not refer to a "transfer of a copyright" or similar intellectual property interest. A transfer of the contract differs from perform the contract through a delegate in that, in the former circumstance, there is no change to or addition of parties to the contract.

3. *Transferability in the Absence of Contract Restrictions.* Subsection (a) adopts the principle that, in the absence of contrary contract terms, contractual interests are presumed transferable unless the transfer adversely affects the interests of the other party. This parallels common law and Article 2 of the Uniform Commercial Code (1998 Official Text). This promotes an optimal open market in contractual rights, enhancing their value to the contracting parties.

a. Federal Policy and Other Law. Paragraph (1) recognizes two limitations on the rule that, when an agreement is silent, transfer of contract interests may be made without consent of the other party. The first is when other law prevents transfer. In licensing, the other source of law may very well come from a federal intellectual property policy that precludes transfer of a non-exclusive copyright or patent license without the consent of the licensor. *Everex Systems, Inc. v. Cadtrak Corp.,* 89 F.3d 673 (9th Cir. 1996); *Harris v. Emus Records Corp.*, 734 F.2d 1329 (9th Cir. 1984); *Unarco*

Indus., Inc. v. Kelley Co., Inc., 465 F.2d 1303 (7th Cir. 1972); *In re Patient Education Media, Inc.,* 210 B.R. 237 (Bankr. S.D.N.Y. 1997); *In re Alltech Plastics, Inc.*, 71 Bankr. 686 (Bankr. W. D. Tenn. 1987). The Copyright Act also precludes the lease, loan or rental of a computer program, even by the owner of a copy, without the permission of the licensor.

When applicable, these federal rules will preempt contrary state law, including the rule in paragraph (1). The federal policy regarding transfers flows in part from the fact that a nonexclusive license is a personal contractual privilege that does not create a property interest. It is also embedded in policies of encouraging innovation and reserving to the rights owner control over to whom and when a license is granted. *See e.g., Everex Systems, Inc. v. Cadtrak Corp.*, 89 F.3d 673 (9th Cir. 1996). This Act does not change that policy but it does set a default rule that creates a contrary starting point.

b. Material Harm to Other Party. The second limit on transferability (when the contract is silent) is that the contract cannot be transferred without consent if such would impair the other party's position in the contract or expectation of performance. In addition to the preclusion of transfers that cause material harm, a transfer may be cause for insecurity and a demand for assurance of future performance. Section 504.

These rules correspond to Article 2 of the Uniform Commercial Code (1998 Official Text) and to the **Restatement (Second) of Contracts** 317. Impairment is often associated with cases in which the transfer is made by a party owing executory or on-going performance and the transfer either purports to shift that performance to a third party or otherwise undermines its occurrence. For example, a transfer of contractual rights under which the transferee holds and has use of trade secret information of the other party will ordinarily be barred because it would place that information in the hands of another person to which the licensor never agreed. Similarly, a transfer that places information in the hands of a competitor or a person who will engage in greater commercial or other use may be precluded if a license for such greater use would ordinarily have required additional terms or consideration.

Material harm should be interpreted here in light of the commercial context and the original expectations of the contracting parties. The issue is not only whether there will be actual harm, but whether there is a material impairment of an expectation of return performance. A continuing sense of security that the promised performance will be forthcoming when due is an important feature of a bargain – parties do not bargain merely for a promise or for the right to win a law suit. The federal policies noted above are relevant. Also, as noted in Article 2A, "[The] lessor is entitled to protect its residual interest in the goods by prohibiting anyone other that the lessee from possessing or using them." Section 2A-303, *Comment* 3. Licensors similarly have residual interests in licensed information.

Computer information transactions involve different background policy and underlying property considerations than Article 2 contracts for sales of goods and this may lead to different decisions about whether a transfer has a material adverse effect. Many non-exclusive licenses may be non-transferable without the licensor's consent. In some commercial licenses, for example, the subject matter includes confidential information that is protected by enforceable contractual use restrictions. In such cases, the party disclosing the confidential information contracts in large part on the basis of the reliability of the particular other party.

There, the presence of confidential information may foreclose non-consensual transfers because the transfer jeopardizes the other party's enforceable interests in confidentiality. The fact that the interest can be protected by a lawsuit for damages dues to wrongful disclosure does not alter the reality that the transfer itself adversely affects the contractual interest. In some cases, a similar conclusion might be reached in the absence of confidential information.

For example, a licensor might agree to license one company, but refuse to license a competitor that otherwise may not have access to the information. In such cases, allowing the licensee to transfer the license without consent adversely affects the licensor's interests as expressed and protected in the original license and given the intangible nature of the property and the ease of its reproduction, in effect places a licensee in direct competition with the licensor as a source of the information. Of course, in some cases, refusals to license may violate other law, but that possibility is outside the scope of this Act.

Mass market licenses present a different context. Transfer of the license will frequently not materially increase the burden or risk imposed on the other party. Even though a mass-market licensee may or may not be an owner of a copy, a transfer complying with Section 117 of the Copyright Act, which allows an owner of a copy to transfer that copy so long as it transfers or destroys all copies in its possession, will often be permissible in the absence of contractual restrictions. Thus, if a consumer licensee transfers his license for word processing software to another consumer and keeps no copy, there may be no impairment under this section. In other

cases, however, a transfer may impair the licensor's interests. For example, if a mass market license for income tax reporting software includes a promise by the licensor to indemnify the licensee against IRS penalties incurred because of defects in the software calculations, repeated transfers of the license multiple times during a tax preparation season may increase in the burden or risk. A transfer of the license along with a single copy by a licensee that retains other copies subject to the same license may also have an adverse impact.

4. *Contractual Restrictions.* Under paragraph (2) terms prohibiting transfer of a contractual interest are enforceable. This rule follows general common law and the approach of the *Restatement*. As *Restatement (Second) of Contracts* 322 notes, policies that disfavor restraints on the alienation of property have little significance with respect to contractual interests. For contractual interests, the dominant policy recognized in the *Restatement* is the ability of the parties to determine the nature and scope of their contract.

When they do so expressly, that choice will be recognized. In reference to licenses, this rule also reflects the importance of the retained interest of the licensor The rule in paragraph (2) parallels that for transfers made without licensor consent in copyright and patent law. *Microsoft Corp. v. Harmony Computers & Electronics, Inc.,* 846 F. Supp. 208 (E.D.N.Y. 1994); *Major League Baseball Promotion v. Colour-Tex*, 729 F. Supp. 1035 (D. N.J. 1990); *Microsoft Corp. v. Grey Computer*, 910 F. Supp. 1077 (D. Md. 1995).

A prohibited transfer is ineffective, rather than merely a breach. "Ineffective" means that the transfer creates no contractual rights or privileges in respect to the relationship of the transferee and the party to the original license who did not participate in the transfer. Between the transferor and its transferee, the transfer does create contractual rights and obligations. Further, while an ineffective transfer creates no rights against the licensor, that does mean that the transfer automatically creates a cause of action for infringement by the licensor against the transferee. Whether that exists is determined by other law. Copyright law would allow a claim of infringement against the transferee if the transferee's conduct infringes exclusive rights under copyright. Trade secret law would often allow a bona fide transferee for value to take free from a remote party's claims. This Act does not change either result.

If information is not protected under copyright, trademark, or patent law, the fact that the transfer is ineffective does not expose the transferee to liability under this section or otherwise. Thus, in trade secret law, a good faith transferee without notice may have a right to use information it receives in violation of trust. That rule is not changed by the contract rule stated here. The rule making a prohibited transfer ineffective merely indicates that the transferee does not receive contractual rights against the party who did not participate in the transfer. However, if there in not proprietary information involved, the absence of those contractual rights is not meaningful. The transferee was not a party to and did not breach the original contract, nor is it subject to an infringing proprietary rights of the non-transferring party.

As between the transferee and the party that did not participate in the transfer, if the rule were otherwise (e.g., the prohibited transfer is effective, but a breach of contract), there would be a potentially significant period of time in which the transferee might be protected by the license before the license could be canceled in litigation. During that time, there could be serious adverse impact on the non-transferring party, despite its contractual effort to limit transferability of the license.

Illustration. Assume a license for $5,000 that allows Small Licensee (SL) (a five employee company) to make "as many copies as needed for use in licensee's business"; the license is expressly not transferable. SL transfers the license to AT&T, a company with 300,000 employees. If the transfer is merely a breach, AT&T may be permitted to make as many copies as it needs for 300,000 employees until licensor cancels the license against SL. The rule making the transfer ineffective preserves the original bargain. As between the SL and AT&T, AT&T would be entitled to refund of the consideration paid for the transfer.

5. *Payment Streams.* Paragraph (2)(B) allows transfer of payment streams despite a contrary contractual provision unless the transfer of the payment stream would make a material change of the other party's position and therefor be precluded under subsection (1). In cases where Article 9 of the Uniform Commercial Code applies, this does not affect the Article 9 rule that, in itself, the contract term cannot preclude such transfer, while also preserving the underlying rule of law that precludes transfers that materially harm the other party.

6. *Mass Market Licenses.* Subsection (c) provides that a term prohibiting transfer of a mass market license must be conspicuous. This refers to terms that prohibit transfer altogether or that preclude all transfers without consent of the licensor; it does not refer to terms that allow transfer but under stated conditions or restrictions, such as permitting transfer if the licensee transfers or destroys all copies in its possession that are subject to the transferred license.

2-504. Shipment by Seller.

Where the seller is required or authorized to send the goods to the buyer and the contract does not require him to deliver them at a particular destination, then unless otherwise agreed he must

(a) put the goods in the possession of such a carrier and make such a contract for their transportation as may be reasonable having regard to the nature of the goods and other circumstances of the case; and

(b) obtain and promptly deliver or tender in due form any document necessary to enable the buyer to obtain possession of the goods or otherwise required by the agreement or by usage of trade; and

(c) promptly notify the buyer of the shipment.

Failure to notify the buyer under paragraph (c) or to make a proper contract under paragraph (a) is a ground for rejection only if material delay or loss ensues.

EFFECT OF TRANSFER OF CONTRACTUAL RIGHTS.

Uniform Law Source: Uniform Commercial Code: Section 2-210; 2A-303 (1998 Official Text) .

Definitional Cross References. Section 102: "Contract"; "Contractual use term": "Party"; "Rights"; "Term";"Transfer".

Official Comments:

1. *Scope of Section.* This section follows Article 2 and 2A of the Uniform Commercial Code (1998 Official Text). It describes the effect of a transfer of contract rights. It is not a comprehensive statement of the law on assignment and delegation. Issues not addressed here are left to other law.

2. *Subject to Contract Terms.* An effective transfer of a contract constitutes a transfer of contract rights and, unless the agreement or the circumstances otherwise indicate, a delegation of contractual duties. The transferee, by accepting the transfer, promises to perform the contract. It is bound by the terms of the original contract, including contractual use terms. The transferee's obligation can be enforced by the other party to the original contract. In effect, as between the transferee and the other party to the original contract, the transfer places the transferee into the position held by its transferor.

However, as between the transferor and the other party to the original contract, paragraph (b)(4) follows current law providing that the transfer does not alter the transferor's obligations to the original contracting party in the absence of a consent by that party to a novation. Mere transfer does not create a novation eliminating the otherwise enforceable contractual rights created between the original parties to the contract.

3. *Transfers in General and for Security.* Subsection (b)(2) recognizes a general rule of construction distinguishing between a commercial assignment of a contract, which substitutes the transferee for the transferor both as to rights and duties, and other transfers that might be for a different purpose such as a transfer to create a security interest under Article 9 of the Uniform Commercial Code. When the latter occurs, the transfer is only to create a security interest and not to delegate duties and rights of the transferor to the secured party.

4. *Assurances.* Subsection (c) recognizes that the non-transferring party has a stake in the reliability, identity or other aspects of the person to whom the contract is transferred. In part, that stake is protected under Section 503. Subsection (c) also gives the non-transferring party a right to demand adequate assurances of future performance and to proceed under Section 708 to protect its interest in performance of the contract. See Comments to Section 503.

2-505. Seller's Shipment Under Reservation.

(1) Where the seller has identified goods to the contract by or before shipment:

(a) his procurement of a negotiable bill of lading to his own order or otherwise reserves in him a security interest in the goods. His procurement of the bill to the order of a financing agency or of the buyer indicates in addition only the seller's expectation of transferring that interest to the person named.

(b) a non-negotiable bill of lading to himself or his nominee reserves possession of the goods as security but except in a case of conditional delivery (subsection (2) of Section 2-507) a non-negotiable bill of lading naming the buyer as consignee reserves no security interest even though the seller retains possession or control of the bill of lading.

(2) When shipment by the seller with reservation of a security interest is in violation of the contract for sale it constitutes an improper contract for transportation within the preceding section but impairs neither the rights given to the buyer by shipment and identification of the goods to the contract nor the seller's powers as a holder of a negotiable document of title.

PERFORMANCE BY A DELEGATE; SUBCONTRACT

Uniform Law Source: Section 2-210; Section 2A-303 (1998 Official Text).

Definitional Cross References. Section 102: "Contract"; "Party"; "Term."

Official Comments:

1. *Performance Through a Delegate.* Performance through a delegate or subcontracting of performance occurs when a party to the original contract uses a third party to make an affirmative performance under a contract. While the performance may be by the delegate, the original party remains bound by the contract and responsible for any breach.

2. *Effect of Contract.* The ability to delegate is subject to terms of the agreement to the contrary. Those terms may be direct or indirect. For example, a contract might expressly preclude delegation or it might restrict use of licensed information to a named person or entity and thus indirectly preclude delegation of the rights or duties to any other person. A contract whose terms are confidential might have the same effect because to disclose contract terms to the delegate (in order to ensure appropriate performance of the contract) might breach the duty of confidentiality.

3. *Delegation in the Absence of a Contract Restriction.* In the absence of a contractual limitation, delegation can occur unless the other party has a substantial interest in having the original party perform or control the performance. Obviously, a party has a substantial interest in having the original party perform if the delegation triggers the restrictions in 503, but it may also have such an interest in other cases. Thus, for example, a contract for software to be developed by an internationally known individual software developer might ordinarily not permit that individual to delegate the development entirely to a third party of lesser stature.

2-506. Rights of Financing agency.

(1) A financing agency by paying or purchasing for value a draft which relates to a shipment of goods acquires to the extent of the payment or purchase and in addition to its own rights under the draft and any document of title securing it any rights of the shipper in the goods including the right to stop delivery and the shipper's right to have the draft honored by the buyer.

(2) The right to reimbursement of a financing agency which has in good faith honored or purchased the draft under commitment to or authority from the buyer is not impaired by subsequent discovery of defects with reference to any relevant document which was apparently regular.

TRANSFER BY LICENSEE.

Uniform Law Source: Uniform Commercial Code: Section 2A-305 (1998 Official Text)

Definitional Cross References.

Section 102: "Copy"; "Information"; "Informational rights"; "License"; "Licensee"; "Party"; "Term"; "Transfer".

Official Comments:

1. *Scope of the Section.* This section deals with the effect of a transfer of a licensee's contractual interest.

2. *Transferee Interests.* Subsection (a) provides that a transferee of the license acquires only the rights that the license and this Act allow. This rule applies to purchasers of contractual interests, including persons who acquire an nterest for the purposes of financing, and to transferees that acquire the transfer by involuntary means, such as enforcement of a judgment. This rule reflects the simple fact that what is transferred is the contract and that the transfer cannot change that contract. This principle holds true even if the transfer includes physical manifestations of the information that is subject to the license. If the transfer is effective, the transferee takes subject to the terms of the license.

3. *Transfers and Underlying Property Rights.* Subsection (b) provides that as a general rule, a licensee's transferee acquires only those contractual or other rights that the licensee was authorized to transfer. This important principle from intellectual property law differs from transactions involving sales of goods. It reflects the fact that one of the property rights created under copyright law is the exclusive right to distribute a work in copies.

A transferee that receives a transfer not authorized by the rights-holder does not acquire greater rights than its transferor was authorized to transfer, even if the party made the acquisition in good faith and without knowledge. As regards intellectual property rights, an unauthorized transfer may itself be a violation of the distribution or other rights of the copyright owner. Ideas of entrustment and bona fide purchase, which play a major role in handling goods, have no similar role in most areas of intellectual property law.

Neither copyright nor patent recognize concepts of protecting a buyer in the ordinary course (or other good faith purchaser) by giving that person greater rights than were authorized to be transferred. Transfers that exceed or are otherwise unlicensed by a patent or copyright owner create no rights of use in the transferee. A transferee that takes outside the chain of authorized distribution does not benefit from ideas of good faith purchase and its use is likely to constitute infringement. See *Microsoft Corp. v. Harmony Computers & Electronics, Inc.,* 846 F. Supp. 208 (ED NY 1994); *Major League Baseball Promotion v. Colour-Tex*, 729 F. Supp. 1035 (D. N.J. 1990); *Microsoft Corp. v. Grey Computer*, 910 F. Supp. 1077 (D. Md. 1995); *Marshall v. New Kids on the Block*, 780 F. Supp. 1005 (S.D.N.Y. 1991).

Subsection (b) recognizes the major exception to this principle, which allows a bona fide purchaser in reference to trade secret claims to the extent that such body of law confers such rights. Trade secret law enforces confidentiality. If a party takes without notice of such confidentiality restrictions, it may not be bound by them; it is in effect a good faith purchaser, free of any obligations under that law. This section does not define when or to what extent this is true, but simply defers to applicable rules under that body of law.

2-507. Effect of Seller's Tender; Delivery on Condition.

(1) Tender of delivery is a condition to the buyer's duty to accept the goods and, unless otherwise agreed, to his duty to pay for them. Tender entitles the seller to acceptance of the goods and to payment according to the contract.

(2) Where payment is due and demanded on the delivery to the buyer of goods or documents of title, his right as against the seller to retain or dispose of them is conditional upon his making the payment due.

[Permanent Editorial Board Commentary]

FINANCING WHERE FINANCIER DOES NOT BECOME LICENSEE.

Definitional Cross References: Section 102: "Financial accommodation contract"; "Financier"; "Information"; "Informational rights"; "License"; "Licensee"; "Licensor".

Official Comments:

1. *Scope of the Section.* This section deals with circumstances in which a financier engaged in a transaction with a licensee does not, as part of that relationship, become a licensee of the license.

2. *Financier.* In this Act, a "financier" is a person who makes a financial accommodation related to a license, but is not the licensor or a secured party. A secured party's position is governed by Article 9 of the Uniform Commercial Code. This Act recognizes two different positions in which a financier may become involved in financing related to a license. The first involves a financing relationship where the financier does not become party to the license. The second is where the financier does become a party to the license and transfers the contractual rights to the party ultimately intended to use the computer information. This latter arrangement resembles a "finance lease" as dealt with in Article 2A of the Uniform Commercial Code, but concerns licensed computer information, rather than leased goods.

2. *Rights of Financier.* If the financier does not become party to the license, it obtains neither the benefits nor the burdens of the license. Under paragraph (2)(C), the financial accommodation contract between the financier and the licensee may add additional conditions to the licensee's right to use the licensed information or rights, but these terms are between the licensee and the financier. This enables this form of financing by enforcing conditions to support it. In effect, to the extent conditions are established in the financial accommodation contract, the licensee contracts away its own contractual right to act under the license, but does not alter or convey any part of, or interest in, the license itself.

3. *Relationship to Licensor.* Paragraph (2) makes clear that, notwithstanding any private arrangement between the licensee and a financier, the contractual and other rights of the licensor are dominant with respect to the licensed information. Thus, the financier's contract cannot alter or expand the licensee's rights under the license.

2-508. Cure by Seller of Improper Tender or Delivery; Replacement.

(1) Where any tender or delivery by the seller is rejected because non-conforming and the time for performance has not yet expired, the seller may seasonably notify the buyer of his intention to cure and may then within the contract time make a conforming delivery.

(2) Where the buyer rejects a non-conforming tender which the seller had reasonable grounds to believe would be acceptable with or without money allowance the seller may if he seasonably notifies the buyer have a further reasonable time to substitute a conforming tender.

FINANCE LICENSES.

Definitional Cross References: Section 102: "Financier"; "Information"; "Informational rights"; "Licensee"; "Licensor"; "Record."

Official Comments:

1. *Scope of the Section.* This section deals with "finance licenses." A "finance license" is analogous to the finance lease in Article 2A of the Uniform Commercial Code, but involves different subject matter and different practical expectations. The transaction involves a license to the financier and an immediate transfer to the financially accommodated licensee. Subsection (a) describes when the retransfer of the license is effective. Subsection (b) deals with some of the resulting substantive conditions among the parties.

2. *Transfer for Financial Purposes.* The basic transaction occurs when a license is made to a financier who then transfers the license to the accommodated licensee. Paragraph (a)(1) sets out two sets of conditions for when this transfer is effective. The first is when a transfer of contractual interests is allowed by Section 503. This occurs when there is no impairment of the licensor's interests and the license does not preclude transfer. The second, provided for in paragraph (a)(1)(B) creates a new method of transfer limited to this context and providing for enhanced opportunities to engage in licnse-based financing. This paragraph establishes a notification procedure requiring clear notice to the licensor, but otherwise enabling an efficient system of allowing the financier's transfer to its client. The notice must be in a record and received by the licensor before the information is delivered or the license granted. It must clearly indicate the intended purpose and name the eventual licensee. Under these conditions, if the accommodated licensee adopts the terms of the license, the transfer or sublicense to it is effective even if there is no formal or express consent by the licensor.

Under paragraph (a)(2), the de facto consent created through this notification procedure covers only the single, designated transfer of contractual rights in the license. Of course, if the contract between the financier and its licensee creates a right to payment to the financier under the license, the financial accommodation contract, or otherwise, a transfer of that payment right is not affected by this rule. In many cases, the transfer of the payment right will be governed by Article 9 of the Uniform Commercial Code. The focus is on transfers by the financier of other rights under the license, such as the right to use or disclose the licensed information.

3. *Licensee's Rights.* Given an effective transfer, paragraph (b)(1) makes clear that the licensee's position with respect to the licensed information is governed primarily by the terms of the license and is subject to the licensor's informational rights. The license is the dominant contractual relationship. The financier and the licensee, however, may agree on additional conditions between themselves. These are enforceable against the licensee even though the primary rights and limitations regarding the information will come from the license and will be the licensor's rights.

4. *Warranties.* Under paragraph (b)(2), as in Article 2A of the Uniform Commercial Code, a financier does not make implied warranties to the accommodated licensee, except for the warranty of non-interference. As to substantive performance issues pertaining to the licensed information, the financier is outside the structure pertinent to the polices that support merchantability and other warranties.

2-509. Risk of Loss in the Absence of Breach.

(1) Where the contract requires or authorizes the seller to ship the goods by carrier

(a) if it does not require him to deliver them at a particular destination, the risk of loss passes to the buyer when the goods are duly delivered to the carrier even though the shipment is under reservation (Section 2-505); but

(b) if it does require him to deliver them at a particular destination and the goods are there duly tendered while in the possession of the carrier, the risk of loss passes to the buyer when the goods are there duly so tendered as to enable the buyer to take delivery.

(2) Where the goods are held by a bailee to be delivered without being moved, the risk of loss passes to the buyer

(a) on his receipt of possession or control of a negotiable document of title covering the goods; or

(b) on acknowledgment by the bailee of the buyer's right to possession of the goods; or

(c) after his receipt of posession or control of a non-negotiable document of title or other direction to deliver in a record, as provided in subsection (4)(b) of Section 2-503.

(3) In any case not within subsection (1) or (2), the risk of loss passes to the buyer on his receipt of the goods if the seller is a merchant; otherwise the risk passes to the buyer on tender of delivery.

(4) The provisions of this section are subject to contrary agreement of the parties and to the provisions of this Article on sale on approval (Section 2-327) and on effect of breach on risk of loss (Section 2-510).

FINANCING ARRANGEMENTS: OBLIGATIONS IRREVOCABLE

Definitional Cross References: Section 102: "Consumer"; "Financier"; "Financial accommodation contract"; "License"; "Licensee"; "Term."

Official Comments:

1. *Scope of the Section.* This section applies irrespective of whether the financier becomes a licensee. It adopts a principle recognized in common law and in Article 2A of the Uniform Commercial Code that allows the creation by contract of irrevocable rights that are independent of otherwise available defenses. As in Article 2A, this principle does not extend to consumer contracts.

2. *Hell or High Water.* This section extends the benefits of the classic "hell or high water" clause to a finance license that is not a consumer license. This section is self-executing; no special provision need be added to the contract. This section makes promises in a financial accommodation contract irrevocable and independent due to the function of the financier in a three party relationship: the licensee is looking to the licensor to perform essential covenants and warranties. Thus, on the licensee's acceptance of the license the licensee's promises to the financier under become irrevocable and independent. The provisions of this section remain subject to the obligation of good faith.

While the accommodated licensee must perform with respect to the financier even if the licensor's performance is not in accordance with the license; the licensee may have and pursue a cause of action against the licensor. This is appropriate because the license is made to and provides the benefit of the licensor's promises and warranties to the licensee. Despite this balance, this section excludes a finance license that is a consumer contract.

2-510. Effect of Breach on Risk of Loss.

(1) Where a tender or delivery of goods so fails to conform to the contract as to give a right of rejection the risk of their loss remains on the seller until cure or acceptance.

(2) Where the buyer rightfully revokes acceptance he may to the extent of any deficiency in his effective insurance coverage treat the risk of loss as having rested on the seller from the beginning.

(3) Where the buyer as to conforming goods already identified to the contract for sale repudiates or is otherwise in breach before risk of their loss has passed to him, the seller may to the extent of any deficiency in his effective insurance coverage treat the risk of loss as resting on the buyer for a commercially reasonable time.

FINANCING ARRANGEMENTS: REMEDIES OR ENFORCEMENT.

Definitional Cross-references: Section 102: "Aggrieved party"; "Cancel"; "Copy"; "Financial accommodation contract"; "Financier"; "Information"; "Informational rights"; "License"; "Licensee"; "Licensor"; "Term; "Transfer".Section 701: "Material Breach."

Official Comments:

1. *Scope of the Section.* The primary relationship between the financier and the licensee is based on their financial accommodation contract. This contact may grant enforcement rights to the financier on breach of that contract. Subsection (a) sets out aspects of the financier's rights on such breach. A premise of this section is that, notwithstanding the rights created under the financial accommodation contract, exercise of those rights is subject to the predominant rights of the licensor under the license.

2. *Rights in the Event of Breach.* Subsection (a)(1) and (a)(2) recognize the enforceability of the financial accommodation contract. Those rights may be subject to the over-riding rights of the original licensor, however, as indicated in paragraphs (a)(3) and (a)(4). Under subsection (a)(4), the remedies in the financial accommodation contract are the only remedies that a financier may exercise if the financier did not become a licensee. This includes the right to enforce contractual rights preventing further use of the information. However, such a right does not give this type of financier a right to possession, control or use of the information itself. That right remains controlled by the license and the licensor.

3. *Finance Licenses (subsection (a)(3)).* Where the transaction involves a finance license in which the financier acquires a license for purposes of transferring it to the licensee, upon breach of the financial accommodation contract the financier has access to the remedies created under this Act, subject to Act restrictions. These remedies are the remedies provided by this Act for breach, not remedies that may be in the license. The financier may also exercise remedies contained in the financial accommodation contract or allowed by other law as applicable.

4. *Other Financiers (subsection (a)(4)).* Subsection (a)(4) deals with cases where the financier did not become a licensee. It recognizes that, as between the financier and licensee, upon breach of the financial accommodation contract the financier has a right to enforce a term in that contract preventing further use of the information. However, that right does not give this type of financier a right to possess or use the information, or to transfer the license. Transfer is not appropriate because the financier did not become a licensee and thus has nothing to transfer. However, a provision of the financial accommodation contract allowing the financier to take possession of or to use information may or may not be written as a transfer of a contractual right that would invoke Section 503. Accordingly, subsection (a)(4) requires compliance with both Section 503 and subsection (b).

5. *Relationship of License and Accommodation Contract.* Subsection (b) sets out additional restrictions on the subsection (a) remedies of the financier. The protections are like those in Section 503 but do not necessarily involve, as does Section 503, a transfer of contractual rights. The basic premise is that actions of the financier and the licensee should not impair the rights of the licensor without appropriate consent, subject to restrictions in federal law. Thus, the financier, notwithstanding any contrary rights under the financial accommodation contract, cannot take possession of or use the information if doing so would adversely affect the licensor. Similarly, except as expressed in paragraph (b)(2), the financier cannot transfer the license or the information.

2-511. Tender of Payment by Buyer; Payment by Check.

(1) Unless otherwise agreed tender of payment is a condition to the seller's duty to tender and complete any delivery.

(2) Tender of payment is sufficient when made by any means or in any manner current in the ordinary course of business unless the seller demands payment in legal tender and gives any extension of time reasonably necessary to procure it.

(3) Subject to the provisions of this Act on the effect of an instrument on an obligation (Section 3-802), payment by check is conditional and is defeated as between the parties by dishonor of the check on due presentment.

FINANCING ARRANGEMENTS: MISCELLANEOUS RULES.

Definitional Cross References: Section 102: "Financier"; "License"; "Licensor"; "Record".

Official Comments:

1. *Effect on Licensor.* While this Act expands the ability of parties to establish financier interests related to a license of computer information, subsection (a) makes clear that creating a financier's interest places no obligations on the licensor, nor does it alter the licensor's rights. An example lies in whether the licensor can, despite the existence of the financier's relationship with the licensee, exercise rights to cancel or otherwise enforce the license. The answer is that licensor's position is not affected by the financier's involvement unless the licensor has otherwise expressly agreed to alter it.

A financier's relationship to a licensee, as is true with a secured creditor's relationship, is dependent and conditional on the terms of the license. A decision by a licensor to cancel the license can be exercised entirely with reference to the financier's contractual position. Once the license is canceled, of course, it no longer provides a basis for the financier's recovery of its loans, but that is inherent in the nature of the relationship itself.

2. *Intellectual Property Rights.* Subsection (b) makes clear that any relationship established between the licensee and a financier does not affect the intellectual property rights of the licensor unless there is an express consent by the licensor to that effect in a record. The consent may be in a license or in another record.

2-512. Payment by Buyer Before Inspection.

(1) Where the contract requires payment before inspection non-conformity of the goods does not excuse the buyer from so making payment unless

(a) the non-conformity appears without inspection; or

(b) despite tender of the required documents the circumstances would justify injunction against honor under this Act (Section 5-109(b)).

(2) Payment pursuant to subsection (1) does not constitute an acceptance of goods or impair the buyer's right to inspect or any of his remedies.

2-513. Buyer's Right to Inspection of Goods.

(1) Unless otherwise agreed and subject to subsection (3), where goods are tendered or delivered or identified to the contract for sale, the buyer has a right before payment or acceptance to inspect them

at any reasonable place and time and in any reasonable manner. When the seller is required or authorized to send the goods to the buyer, the inspection may be after their arrival.

(2) Expenses of inspection must be borne by the buyer but may be recovered from the seller if the goods do not conform and are rejected.

(3) Unless otherwise agreed and subject to the provisions of this Article on C.I.F. contracts (subsection (3) of Section 2-321), the buyer is not entitled to inspect the goods before payment of the price when the contract provides

(a) for delivery "C.O.D." or on other like terms; or

(b) for payment against documents of title, except where such payment is due only after the goods are to become available for inspection.

(4) A place or method of inspection fixed by the parties is presumed to be exclusive but unless otherwise expressly agreed it does not postpone identification or shift the place for delivery or for passing the risk of loss. If compliance becomes impossible, inspection shall be as provided in this section unless the place or method fixed was clearly intended as an indispensable condition failure of which avoids the contract.

2-514. When Documents Deliverable on Acceptance; When on Payment.

Unless otherwise agreed documents against which a draft is drawn are to be delivered to the drawee on acceptance of the draft if it is payable more than three days after presentment; otherwise, only on payment.

2-515. Preserving Evidence of Goods in Dispute.

In furtherance of the adjustment of any claim or dispute

(a) either party on reasonable notification to the other and for the purpose of ascertaining the facts and preserving evidence has the right to inspect, test and sample the goods including such of them as may be in the possession or control of the other; and

(b) the parties may agree to a third party inspection or survey to determine the conformity or condition of the goods and may agree that the findings shall be binding upon them in any subsequent litigation or adjustment.

PART 6. BREACH, REPUDIATION AND EXCUSE [Table of Contents]

2-601. Buyer's Rights on Improper Delivery.

Subject to the provisions of this Article on breach in installment contracts (Section 2-612) and unless otherwise agreed under the sections on contractual limitations of remedy (Sections 2-718 and 2-719), if the goods or the tender of delivery fail in any respect to conform to the contract, the buyer may

(a) reject the whole; or

(b) accept the whole; or

(c) accept any commercial unit or units and reject the rest.

PERFORMANCE OF CONTRACT IN GENERAL.

Uniform Law Source: Restatement (Second) of Contracts § 237. Revised. Uniform Commercial Code: Section 2-507 (1998 Official Text).

Definitional Cross References. Section 102: "Aggrieved party"; "Agreement"; "Cancel"; "Contract"; "Contractual use term"; "Copy"; "Party".

Official Comments:

1. *Scope of the Section.* This section brings together general principles pertaining to performance of a contract. In cases where performance involves a tender of a copy, under subsection (d), this section is supplanted by specific sections on tender, acceptance, and refusal of copies. This section and Parts 6 and 7 of this Act generally, use the term "refusal" in circumstances where Article 2 of the Uniform Commercial Code would use the term "rejection." The concepts are similar, although the differences between information and goods precludes rote application of Article 2 rules.

2. *Duty to Conform.* A party must conform to its contract. A failure to conform gives the aggrieved party a right to a remedy, subject to concepts of waiver. Under this Act, what remedies are available depends on the agreement and, in absence of agreement, on whether the breach was material. Under the *Restatement* view, and as adopted here, a party's duty to perform is contingent on the absence of an uncured prior material breach by the other party. See *Restatement (Second) of Contracts* § 237. This contingent relationship described in subsection (b) does not refer to contractual

use terms. A breach by one party does not allow the other to ignore those restrictions on use. This is true even if the aggrieved party has a duty to mitigate loss. A breach by the licensor does not give the licensee unfettered rights to act in derogation of use restrictions or to ignore the intellectual property rights that may buttress them.

3. *Material Breach.* Subsection (b) follows the *Restatement (Second) of Contracts* and common law and adopts the standard of material breach for determining the nature of the remedies available for breach by the other party. The concept of material breach is applied throughout contract law and has been relied on by courts for generations. It holds that a minor defect in performance does not warrant rejection or cancellation of a contract. While minor problems may indicate a breach, the remedy lies in recovery of damages. The policy underlying the idea of material breach is to avoid forfeiture for small errors. Often, truly perfect performance cannot even be expected. If the parties desire to create a more stringent standard, they must do so by the terms of their agreement. The material breach standard applies to both the licensor and the licensee. A licensor that receives imperfect performance cannot cancel the contract on account of a minor problem, nor can the licensee that receives imperfect performance from the licensor. In both cases, the imperfect performance may yield a right to damages.

4. *Conforming Tender: Mass Market.* Under subsection (b)(1), the material breach standard does not apply as a precondition to refuse a performance or cancel a contract in mass-market transactions involving mass market tenders of delivery of a copy. See Section 704(b). Instead, this Act adopts the rule followed in Article 2 and Article 2A of the Uniform Commercial Code. These statutes stand alone in contract law in not using the material breach concept, but do so but only in one situation: a single delivery of goods not part of an installment contract.

This Act adopts the conforming tender rule as a basis to refuse a performance or cancel a contract for cases involving delivery of a copy in mass-market transactions, thereby creating a rule that parallels Article 2. The "conforming [perfect] tender" rule is not a "perfect" tender rule even in Article 2. What is a conforming tender is restricted by legal considerations regarding merchantability, and by principles such as usage of trade and course of performance. It is further limited by principles of waiver and a right to cure. As one leading treatise comments: "[we have found no case that] actually grants rejection on what could fairly be called an insubstantial non-conformity . . .**"**

5. *Duty to Accept and Tender.* Subsection (c) brings together general rules from the Restatement and Uniform Commercial Code Article 2 (1998 Official Text) regarding the presumed sequence of performance where mutual performances are to be exchanged. The primary principle is that tender of performance entitles the tendering party to acceptance of that performance. The rule is stated in general terms here. Of course, if the tendered performance is a material breach, the party receiving the tender is not required to perform. As subsection (d) indicates, where the performance is delivery of a copy, these general rules are subject to the more specific rules on tender and acceptance of copies in sections 606 through 610, and 704 through 707.

6. *Refusing a Performance and Cancellation.* An important distinction exists between the right to refuse a particular performance and the right to cancel the entire contract. A party may refuse a performance if it fails to conform to the contract and consists of a material breach as to that performance. Whether that breach also allows the party to cancel the entire contract depends on whether the breach is material to the entire contractual relationship. In contracts where the entire performance is delivery of a single copy, a right to refuse the copy corresponds to the right to cancel the contract. In more complex situations, a single breach may not be material to the whole agreement. Thus, for example, a payment that is one-half the required amount is a material breach as to that payment, but whether it also constitutes a material breach of the entire contract depends on the circumstances and the agreement.

2-602. Manner and Effect of Rightful Rejection.

(1) Rejection of goods must be within a reasonable time after their delivery or tender. It is ineffective unless the buyer seasonably notifies the seller.

(2) Subject to the provisions of the two following sections on rejected goods (Sections 2-603 and 2-604),

(a) after rejection any exercise of ownership by the buyer with respect to any commercial unit is wrongful as against the seller; and

(b) if the buyer has before rejection taken physical possession of goods in which he does not have a security interest under the provisions of this Article (subsection (3) of Section 2-711), he is under a duty after rejection to hold them with reasonable care at the seller's disposition for a time sufficient to permit the seller to remove them; but

(c) the buyer has no further obligations with regard to goods rightfully rejected.

(3) The seller's rights with respect to goods wrongfully rejected are governed by the provisions of this Article on seller's remedies in general (Section 2-703).

LICENSOR'S OBLIGATIONS TO ENABLE USE.

Definitional Cross References. Section 102: "Access contract"; "Access material"; "Agreement"; "Contract"; "Deliver"; "Information"; "Informational Rights"; "Licensee"; "Licensor"; "Record"; "Transfer."

Official Comments:

1. *Scope of the Section.* This section states and defines the licensor's general obligation to enable use of the information or access that it provides to the licensee. The licensor's obligation depends on the agreement, but in most cases in commerce it consists of two elements: making the information available (if necessary) and giving authority or permission to use the information. The alternatives in subsection (b) conform to that dual requirement.

2. *No Acts Required.* In computer information transactions. a licensor may or may not be required to deliver anything. Instead, in many cases, it will suffice to authorize use of information that the licensee obtained from other sources or to authorize access to information. Paragraph (b)(1) recognizes the importance of that fact and the role of mere authorization of use or access in such cases,, e.g., when a party is already in possession of a photograph that it desires to use in a digital multi-media work, but must obtain permission to do so from the photographer holding the copyright.

3. *Tender of Copy.* Paragraph (b)(2) deals with cases where enabling use under the agreement requires providing a copy of the information. The rule it states parallels existing law concerning goods. The obligation is to tender delivery of the copy to the licensee.

4. *Access Material.* Subsection (b)(3) requires the licensor to supply necessary authorization codes or other access materials to obtain the agreed access. It is limited to items unique to that access such as a password; the fact that access may assume use of generic items such as a computer or a particular kind or version of software browser does not make those items "access materials" or require the licensor to supply them in order to enable use.

5. *Recording Information.* If the agreement involves a transfer of ownership of informational rights and a filing or other recording is needed to complete that transfer so as to have priority over other transfers, subsection (b)(4) indicates that the licensor must cooperate in completing that recording.

2-603. Merchant Buyer's Duties as to Rightfully Rejected Goods.

(1) Subject to any security interest in the buyer (subsection (3) of Section 2-711), when the seller has no agent or place of business at the market of rejection a merchant buyer is under a duty after rejection of goods in his possession or control to follow any reasonable instructions received from the seller with respect to the goods and in the absence of such instructions to make reasonable efforts to sell them for the seller's account if they are perishable or threaten to decline in value speedily. Instructions are not reasonable if on demand indemnity for expenses is not forthcoming.

(2) When the buyer sells goods under subsection (1), he is entitled to reimbursement from the seller or out of the proceeds for reasonable expenses of caring for and selling them, and if the expenses include no selling commission then to such commission as is usual in the trade or if there is none to a reasonable sum not exceeding ten per cent on the gross proceeds.

(3) In complying with this section the buyer is held only to good faith and good faith conduct hereunder is neither acceptance nor conversion nor the basis of an action for damages.

SUBMISSIONS OF INFORMATION TO SATISFACTION OF PARTY.

Definitional Cross References. Section 102: "Agreement"; "Information"; "Party"; "Record". Section 114: "Reasonable time."

Comments:

1. *Scope of the Section.* This section deals with situations where rules patterned after rule for the sale of goods involving tender, acceptance and rejection of the goods are not appropriate because the agreement calls for submissions of informational content to the satisfaction of the receiving party. The section excludes sale of goods standards in such cases, and focuses on industry practices . The section deals only with contract issues and does not address liability or rights under other law.

2. *Tender-acceptance Rules Not Applicable.* Under paragraph (1), rules in this Act regarding tender, acceptance and rejection of copies do not apply where the transaction involves information submitted under terms providing for approval to the satisfaction of the licensee. The rules dealing with copies in this Act are modeled on rules regarding the sale of goods. There, the focus is on making decisions about the particular item. In computer information transactions of the type described here, a submission triggers a process that centers around the commercial expectation that the recipient has

the right to reject if the submission does not satisfy its expectations, but that immediate acceptance or rejection will often not occur. A process of revision and tailoring more commonly occurs. The rule here corresponds the law to ordinary commercial expectations in these fields.

3. *Express Choices.* Acceptance or rejection of the submission is not to be implied from delay and silence alone. Consistent with ordinary practices, paragraph (3) makes clear that only explicit refusal or acceptance suffices since the agreement is conditioned on the satisfaction of the receiving party. However, until acceptance, the recipient cannot "use" the submitted information. This refers to commercial exploitation and does not, of course, prevent use for the purpose of reviewed, correcting, or otherwise adjusting the information to meet the recipient's satisfaction.

4. *Demand for Decision.* Under paragraph (3), express choices supplant rules that might operate from failure to reject or from delays in submitting changes. However, paragraph (4) recognizes that in some cases an extraordinary delay in responding creates rights in the submitting party to obtain a firm answer. What constitutes sufficient delay for this purpose must, of course, be judged in reference to ordinary commercial standards associated with the applicable context.

2-604. Buyer's Options as to Salvage of Rightfully Rejected Goods.

Subject to the provisions of the immediately preceding section on perishables if the seller gives no instructions within a reasonable time after notification of rejection the buyer may store the rejected goods for the seller's account or reship them to him or resell them for the seller's account with reimbursement as provided in the preceding section. Such action is not acceptance or conversion.

IMMEDIATELY COMPLETED PERFORMANCE

Definitional Cross References. Section 102; "Agreement"; "Delivery"; "Information"; "Licensee"; "Party".

Official Comments:

1. *Scope of the Section.* This section deals with subject matter that is, in effect, fully received when made available to, or viewed or read by the transferee. For this subject matter, concepts of inspection, rejection and return from the sales of goods law cannot apply.

This section applies, for example, in a case where the licensed subject matter is the results of a database search for the top selling consumer product in May. Once performed and revealed to the transferee, the subject matter cannot be returned. The subject matter of the contract involves informational content that, once seen, has communicated the value that exists in the performance.

2. *General Rules Govern.* For these transactions, the section leaves the parties to the general rules of Section 601 which incorporate common law, along with ordinary standards of the relevant business, trade or industry. Reliance on the sections of this Act dealng with tender and handling of copies is excluded because those rules are modeled after rules relating to transfer of goods and do not accommodate the reality and commercial expectations found in these transactions.

3. *Inspection.* In transactions governed by this section, merely viewing or receiving the information transfers significant value to the licensee which cannot be returned. Given that fact, subsection (3) clarifies that inspection rights are limited to media and packaging. A person that joins a fee-based celebrity chat room cannot participate (e.g., receive the performance) before deciding whether to accept or not accept it. The participation itself transfers the value and that value cannot be returned. A person licensing the formula for Coca Cola cannot view the information and potentially memorize the formula before being bound to the contract and its performance under the contract. Of course, in these and all other cases, if the performance when received does not conform to the contract, the aggrieved party is entitled to its remedies for breach.

2-605. Waiver of Buyer's Objections by Failure to Particularize.

(1) The buyer's failure to state in connection with rejection a particular defect which is ascertainable by reasonable inspection precludes him from relying on the unstated defect to justify rejection or to establish breach

(a) where the seller could have cured it if stated seasonably; or

(b) between merchants when the seller has after rejection made a request in writing for a full and final written statement of all defects on which the buyer proposes to rely.

(2) Payment against documents made without reservation of rights precludes recovery of the payment for defects apparent in the documents.

ELECTRONIC REGULATION OF PERFORMANCE.

Definitional Cross References. Section 102: "Agreement"; "Contract"; "Copy"; "Delivery"; "Electronic"; "Information"; "Informational rights"; "License"; "Licensee"; "Licensor"; "Notice"; "Party"; "Term"; "Termination."

Official Comments:

1. *Scope of the Section.* This section deals with electronic or physical limitations on use of information that enforce contract terms by **preventing** breach, but preventing uses that are inconsistent with the contract, or by implementing a contracted-for termination of rights to use the information. The section does not deal with devices used to enforce rights in the event of cancellation for a breach or with enforcement concerning information that is outside the subject matter of this Act. The restraints here derive from contract terms and limit use consistent with the contract or the termination of a license at its natural end. The basic principle is that a contract can be limited to its terms and that it is appropriate to do so through automated means.

2. *Nature of a Restraint.* The idea of a "restraint" is analogous to the concept in the Copyright Act of a technological measure restricting access to a copyrighted work, but is keyed to contract terms, rather than copyright protection. 17 U.S.C. § 1201 (1999). It does not refer to situations in which the formatting, language or other characteristics of the computer information itself by their nature limit how access to or use of information can occur, nor does it create an affirmative obligation to prepare or transform information in a manner so that it will accessible by other systems – incompatibilities are not "restraints" as used in this section. Rather, "restraints" refers to a technological or physical measure whose intended purpose is to create a limitation to conform use of the information to the contract, such as a device that restricts access at the end of the duration of a license. An analog in a physical world would be the timing device that limits a laundromat dryer to 30 minutes use if only a 30 minute duration was purchased.

3. *Bases for Use.* Subsection (b) states alternative bases that permit use of automated restraints. The alternatives are co-equal; satisfying any one supports use of the restraint under this section. The list is not exclusive and does not limit federal or other law (including other contract law) allowing use of limiting devices (restraints).

a. Contract Authorization. Subsection (b)(1) applies if the agreement authorizes the party to use the restraint. The authorization must be in addition to the contract term that the restraint enforces. Thus to be within subsection (b)(1) in a contract for 30 minutes of use, an agreement must also contain a term authorizing use of a restraint to enforce that limitation of duration of use.

b. Passive Restraints That Prevent Breach. Subsection (b)(2) provides that a restraint can be used without notice or specific contract authorization if it merely prevents use inconsistent with contract terms or with the intellectual property rights of the party using the restraint. All the restraint may do is prevent use; if it does more than that, it is not authorized by this subsection. For example, if a license restricts the licensee to only one back-up copy, this subsection authorizes a restraint to enforce that limitation so long as the restraint does not destroy the licensed information. However, an agreement that limits use to a particular location may allow destruction of the copy of the information at the unauthorized location. The licensee still retains the information at the appropriate location. Restraints enforce contracts, but do not impose a penalty for attempted breach. Thus, if an enforceable contract term limits use of a copy of digital information to a single concurrent user, a restraint precluding multiple concurrent users is authorized. A restraint that deletes the authorized digital copy if the licensee attempts to multiple concurrent users is not authorized by this subsection. The agreement must support the restraint. . A restraint inconsistent with the contract is a breach of contract.

c. Enforcing Informational Rights. Subsection (b)(2) also allows use of passive devices that preclude infringing informational rights. Merely preventing the act does not require a contract or other notice. Thus, a contract that grants a right to make a back-up copy and to use a digital image, is silent on the right of the licensee to transmit additional copies electronically, although such may be precluded by intellectual property law absent fair use. A device that precludes communication of the file electronically, but does not alter or erase the image in the event of an attempt to do so, is authorized under (b)(2).

d. Enforcing Termination. The restraints authorized in subsections (b)(3) and (b)(4) enforce termination. Termination ends the contract for reasons other than breach. Subsection (b)(3) allows restraints that end use upon expiration of a stated term or number of uses. At termination, the restraint may do more than merely prevent use because, at the end of the contract period, the party no longer has any rights in the information under the license. Thus, a machine allowing a single video game play can automatically discontinue use or delete the game when that game is completed. A license for a time limited use of downloaded software fragments allows erasure of those elements when the limited time for use expires. Consistent with general contract law rules on

termination, no prior notice is required for such termination. In contrast, subsection (b)(4) requires prior notice if the restraint implements termination other than on the happening of an agreed event.

4. *Licensee's Information.* Under subsection (c), nothing in this section authorizes active devices that affirmatively limit the licensee's ability to access or use its own information through its own means (means other than by continued use of the licensed subject matter itself). Thus if a licensee storing data on its own Internet server contracted to use spreadsheet application X for 30 minutes with that data, a restraint in the spreadsheet may terminate its use after 30 minutes but may not block access to the data. If the licensee obtains a license to use spreadsheet application Y, it may access its data with the new spreadsheet but may not continue to use spreadsheet X to do so (absent a license for additional use).

5. *Cancellation.* Cancellation means ending a contract because of breach. Subsection (f) makes it clear that nothing in this section authorizes or otherwise deals with electronic or other devices used to enforce rights in the event of breach and cancellation.

Illustration. A license requires monthly payments on the first and runs for one year. Licensee makes one payment five days late. Licensor uses an electronic device to turn off the software since payment was late and breach has occurred. That act is not authorized under this section since it is an action that depends on breach of contract. If, however, after the license reaches the end of the contracted year a restraint turns off and deletes the software, such does not depend upon breach and is valid under this section.

Note that while Section 816 on electronic self-help can be used electronically to enforce rights after breach, in the example, Section 816 also would not authorize the licensor's actions (e.g., licensor failed to provide the notice and comply with the other limitations of Section 816).

2-606. What Constitutes Acceptance of Goods.

(1) Acceptance of goods occurs when the buyer

(a) after a reasonable opportunity to inspect the goods signifies to the seller that the goods are conforming or that he will take or retain them in spite of their non-conformity; or

(b) fails to make an effective rejection (subsection (1) of Section 2-602), but such acceptance does not occur until the buyer has had a reasonable opportunity to inspect them; or

(c) does any act inconsistent with the seller's ownership; but if such act is wrongful as against the seller it is an acceptance only if ratified by him.

(2) Acceptance of a part of any commercial unit is acceptance of that entire unit.

COPY: DELIVERY; TENDER OF DELIVERY.

Uniform Law Source: Uniform Commercial Code: Sections 2-503; 504 (1998 Official Text).

Definitional Cross References: Section 102: "Agreement"; "Access Materials"' "Copy"; "Delivery"; "Document of title"; "Electronic;" "Information"; "Licensor"; "Notice"; "Party"; "Person"; "Receive"; "Send"..

Official Comments:

1. *Scope of the Section.* This section deals with tender of delivery of a copy. It corresponds to Article 2 of the Uniform Commercial Code (1998 Official Text) with changes that reflect information as the subject matter.

2. *Shipment vs. Destination Contracts.* Subsection (a) maintains the traditional distinction between shipment and destination contracts as that rule exists under Article 2 of the Uniform Commercial Code (1998 Official Text) and also the underlying doctrine as to determining when a contract is a shipment or a destination contract. The norm is for a shipment contract; destination contracts are the exception which require an explicit agreement or use of destination contract shipping terms in the computer information contract (use of trade terms in a contract of carriage may carry different meanings than the terms described here).

For illustrative cases, see *California State Electronics Assoc. v. Zeos International Ltd.,* 49 Cal. Rptr. 2d 127 (Cal. App. 2 Dist. 1996) and *Windows, Inc. v. Jordan Panel Systems Corp.*, 38 UCC Rep. Serv. 2d 267 (2d Cir. 1999). The strong presumption is that the licensor is not required to deliver to a particular destination unless the agreement explicitly so provides. Thus, the obligation in the absence of agreement is to make the copies available at the licensor's site (in Incoterms, the "E" terms (EXW-Ex Works)) or, if shipment is agreed, to tender them per the licensee's instructions for carriage or to a transmission facility making appropriate arrangements for their transport or transmission, with fees payable by the licensee.

Merely designating a place to which shipment will be made does not create a "destination" contract or alter the presumption that a "shipment contract" is intended. U.C.C. examples of shipment contract terms include "F.O.B. point of shipment" (Article 2-504), "C.I.F.", "C.I.F. destination" and "C.&F." (Article 2-320). Under the international 1990 Incoterms, shipment contracts include the "F" terms and the "C" terms such as "FCA" (Free Carrier),_CIF (Cost, Insurance and Freight),_but not the "D" terms such as "DAF" (Delivered At Frontier). The "D" terms are destination contracts, also known as "arrival" contracts. Customs of ports and regions, as well as trade usage, can also influence the meaning of trade terms.

3. *Tender of a Copy.* Subsection (b) provides default rules regarding what constitutes tender of delivery of a copy. These rules generally correspond to Uniform Commercial Code Article 2 (1998 Official Text) and to the *Restatement (Second) of Contracts.* A tender requires that the cpy be put and held available at the appropriate place and the other party notified of the tender.

4. *Electronic Tender.* Subsection (b)(2)(B) recognizes that electronic tenders of a copy may or may not involve transmission by the tendering party itself. That party may instead contract with the equivalent of an electronic carrier who is better suited to make transmissions, such as secure transmissions. In that event, putting the copy into the hands of, or otherwise making it available to, the electronic transmitter has the same effect as putting a physical copy into the hands of a traditional carrier or the like.

2-607. Effect of Acceptance; Notice of Breach; Burden of Establishing Breach After Acceptance; Notice of Claim or Litigation to Person Answerable Over.

(1) The buyer must pay at the contract rate for any goods accepted.

(2) Acceptance of goods by the buyer precludes rejection of the goods accepted and if made with knowledge of a non-conformity cannot be revoked because of it unless the acceptance was on the reasonable assumption that the non-conformity would be seasonably cured but acceptance does not of itself impair any other remedy provided by this Article for non-conformity.

(3) Where a tender has been accepted

(a) the buyer must within a reasonable time after he discovers or should have discovered any breach notify the seller of breach or be barred from any remedy; and

(b) if the claim is one for infringement or the like (subsection (3) of Section 2-312) and the buyer is sued as a result of such a breach he must so notify the seller within a reasonable time after he receives notice of the litigation or be barred from any remedy over for liability established by the litigation.

(4) The burden is on the buyer to establish any breach with respect to the goods accepted.

(5) Where the buyer is sued for breach of a warranty or other obligation for which his seller is answerable over

(a) he may give his seller written notice of the litigation. If the notice states that the seller may come in and defend and that if the seller does not do so he will be bound in any action against him by his buyer by any determination of fact common to the two litigations, then unless the seller after seasonable receipt of the notice does come in and defend he is so bound.

(b) if the claim is one for infringement or the like (subsection (3) of Section 2-312) the original seller may demand in writing that his buyer turn over to him control of the litigation including settlement or else be barred from any remedy over and if he also agrees to bear all expense and to satisfy any adverse judgment, then unless the buyer after seasonable receipt of the demand does turn over control the buyer is so barred.

(6) The provisions of subsections (3), (4) and (5) apply to any obligation of a buyer to hold the seller harmless against infringement or the like (subsection (3) of Section 2-312).

COPY: PERFORMANCE RELATED TO DELIVERY; PAYMENT.

Uniform Law Source: Uniform Commercial Code: Sections 2-307; 2-511 (1998 Official Text).

Definitional Cross References: Section 102: "Contract fee"; "Copy"; "Delivery"; "Document of title;" "Party."

Official Comments:

1. *Scope of the Section.* This section brings together various a variety of rules from Article 2 of the Uniform Commercial Code (1998 Official Text) and from the Restatement (Second) of Contracts as applicable, to transfers involving delivery of a copy.

2. *Basic Rule.* The basic approach adopted here is consistent with Section 601 and follows Article 2. A tender of a performance (in this case, delivery of a copy) is a condition to the duty to accept the copy and to the obligation to pay for that copy on delivery. This is a default rule that is subject to contrary agreement, including the implications of the transaction and the effect of applicable usage of trade. In many computer information transactions, the commercial context and the agreement of the parties alters this expectation. For example, an agreement that involves payment of royalties alters the default rule in that royalties cannot accrue until use of the licensed information occurs. In such contracts, payment is due as agreed. Agreement for this purpose can be found in express terms as well as in the actions of the parties or inferred from the commercial circumstances.

2-608. Revocation of Acceptance in Whole or in Part.

(1) The buyer may revoke his acceptance of a lot or commercial unit whose non-conformity substantially impairs its value to him if he has accepted it

(a) on the reasonable assumption that its non-conformity would be cured and it has not been seasonably cured; or

(b) without discovery of such non-conformity if his acceptance was reasonably induced either by the difficulty of discovery before acceptance or by the seller's assurances.

(2) Revocation of acceptance must occur within a reasonable time after the buyer discovers or should have discovered the ground for it and before any substantial change in condition of the goods which is not caused by their own defects. It is not effective until the buyer notifies the seller of it.

(3) A buyer who so revokes has the same rights and duties with regard to the goods involved as if he had rejected them.

(4) If a buyer uses the goods after a rightful rejection or justifiable revocation of acceptance, the following rules apply:

(a) Any use by the buyer that is unreasonable under the circumstances is wrongful as against the seller and is an acceptance only if ratified by the seller.

(b) Any use of the goods that is reasonable under the circumstances is not wrongful as against the seller and is not an acceptance, but in an appropriate case the buyer is obligated to the seller for the value of the use to the buyer.

COPY: RIGHT TO INSPECT; PAYMENT BEFORE INSPECTION.

Uniform Law Source: CISG art. 58(3); Uniform Commercial Code: Sections 2-512; 513 (1998 Official Text).

Definitional Cross References: Section 102: "Agreement"; "Contract"; "Copy"; "Delivery"**;** "Letter of credit"; "Party".

Official Comments:

1. *Scope of the Section.* This section deals with the right to inspect a copy and its relationship to acceptance of the copy and the duty to pay. It follows Article 2 of the Uniform Commercial Code (1998 Official Text) with changes that reflect computer information as the subject matter.

2. *Relationship to Acceptance.* An opportunity to inspect a copy is ordinarily a condition to acceptance of the copy. Acceptance in this sense refers to acceptance of the copy and not to agreement to or adoption of contract terms. A contract ordinarily exists before delivery or an opportunity to inspect the product delivered. Where payment occurs before an opportunity to inspect the copy, subsection (d) makes clear that payment is not acceptance of the copy. Thus, for example, the licensee may nevertheless refuse the copy because of a defect once an opportunity to inspect is had. This is the same rule as in Article 2.

3. *Type of Inspection.* The type of inspection permitted depends on the commercial context, including the agreement of the parties. This follows Article 2 and cases decided under Article 2 are applicable in interpreting this section. If the parties agree to an extended or extensive procedure of pre-acceptance testing, that agreement supplants the general standard of this section. In the absence of agreement, the standard is that inspection must be in a reasonable time and manner.

4. *Confidentiality Obligations.* Under subsection (a)(4), if a party is under an obligation of confidentiality, its inspection of a copy is subject to that obligation. The requirement that the obligation be "existing" requires that it be in the contract giving rise to the inspection or another agreement, including agreements formed by course of dealing, usage of trade and the like. However, the inspecting party is not required to infer or presume an obligation of confidentiality.

5. *Defects Not Discovered.* As in Article 2, a failure to inspect or a failure to discover all defects during an inspection does not necessarily alter the party's remedies for the undiscovered defect. If a latent

defect exists which was not known to the accepting party, acceptance of the copy does not alter that party's right to a remedy for the defect when eventually discovered. Section 610. The right to inspect should be contrasted to the rule stated in Section 402 which deals with the effect of an examination of the copy on the existence of an express warranty. Both rules conform to Article 2 (1998 Official Text). "Examination" as a means of establishing contract terms or warranties infers a more extended opportunity to analyze the copy than does the right to inspect before acceptance of a copy under this section.

2-609. Right to Adequate Assurance of Performance.

(1) A contract for sale imposes an obligation on each party that the other's expectation of receiving due performance will not be impaired. When reasonable grounds for insecurity arise with respect to the performance of either party the other may in writing demand adequate assurance of due performance and until he receives such assurance may if commercially reasonable suspend any performance for which he has not already received the agreed return.

(2) Between merchants the reasonableness of grounds for insecurity and the adequacy of any assurance offered shall be determined according to commercial standards.

(3) Acceptance of any improper delivery or payment does not prejudice the aggrieved party's right to demand adequate assurance of future performance.

(4) After receipt of a justified demand failure to provide within a reasonable time not exceeding thirty days such assurance of due performance as is adequate under the circumstances of the particular case is a repudiation of the contract.

WHEN ACCEPTANCE OCCURS.

Uniform Law Source: Uniform Commercial Code Sections 2-606; 2A-515 (1998 Official Text).

Definitional Cross References: Section 102: "Agreement"; "Contract"; "Contractual use term"; "Copy"; "Delivery;" "Information"; "Licensor"; "Party". **Official Comments:**

1. *Scope of the Section.* This section deals with what constitutes acceptance of a copy. The effect of acceptance of a copy is stated in Section 610. This section derives from and corresponds to Article 2 and Article 2A. It does not deal with "offer" and "acceptance" as they pertain to formation of a contract or adoption of terms.

2. *Nature of Acceptance.* Acceptance of a copy is the opposite of refusal of a copy. Under Section 610(a), acceptance precludes refusal and, if made with knowledge of any nonconformity, may not be revoked because of it unless acceptance was on the reasonable assumption that the nonconformity would be seasonably cured. Acceptance puts the burden on the party accepting the copy to prove any breach with respect to that copy. See Section 601. However, while acceptance of a copy precludes refusal of it unless acceptance is revoked, acceptance does not in itself impair any other remedy for nonconformity.

3. *What Constitutes Acceptance.* Subsection (a) provides guidance on what constitutes acceptance of a copy. Paragraphs (a)(1) and (a)(2) conform to Uniform Commercial Code Article 2-606 and to Article 2A (1998 Official Text). Acts as well as communications may signify acceptance. Similarly, a failure to reject constitutes acceptance, even if there has been no communication to that effect to the other party. These rules must be read in connection with subsection (b) which indicates that the referenced acts or communications are not acceptance (if the party had a right to inspect the information or copy under the agreement or the default rules of this Act) unless they occur after a reasonable opportunity to inspect.

a. Commingling. Paragraphs (a)(3) and (a)(4) focus on two circumstances significant in reference to computer information that raise issues different from cases involving goods. Paragraph (a)(3), reflects that it is inequitable or impossible to reject data or information after having commingled it. The commingling party retains its remedies for breach, but commingling renders inappropriate the remedy a refusal of the copy.

To refuse a copy (or revoke an acceptance of it), the refusing party must return or keep it available for return to the other party: commingling precludes this. Commingling refers to blending the information into a common mass in which it is indistinguishable. It also refers to software integrated into a complex system in a way that renders removal and return impossible or information integrated into a database or knowledge base from which it cannot be separated.

b. Non-returnable Benefits. Subsection (a)(4) treats as acceptance the receipt, use or exploitation of the value of the information provided by the licensor. In information transactions, in many instances merely being exposed to the factual or other material transfers the significant value. See Comments to Section 604. Often, use of the information does the same. Again, refusal is not a useful paradigm as a remedy. The recipient can sue for damages for breach and, depending on the

nature and extent of breach, either obtain reimbursement of the price or avoid paying a price that would otherwise be due.

c. Ownership. Paragraph (a)(5) follows the rule in Uniform Commercial Code Article 2 (1998 Official Text). In Article 2, the rule is that, even if the buyer did not explicitly accept the goods, acts inconsistent with the seller's ownership constitute acceptance if ratified by the seller. This gives the seller faced with such conduct an option to either treat the acts as acceptance, or as a rejection followed by acts of conversion or the like.

In information transactions, however, the options are less clear than in sales of goods, since a licensee can avoid explicit acceptance of the information, but then act in a manner that is outside the contract terms, even had it accepted the tender. Paragraph (a)(5) gives the licensor a right to elect where the inconsistent acts are within contractual use terms. It modifies the Article 2 rule and recognizes that if the licensor decides to treat the acts as acceptance, it need not also ratify actions of a licensee's that would, in any event, be outside the contract terms and constitute infringement.

For example, if a licensor provides a conforming copy of educational software for use in a single school district and the district, while not signifyin acceptance of the copy, distributes the software throughout the country, the licensor can either: 1) treat the silence as refusal of the tender and sue for breach of contract and infringement, or 2) treat the actions as acceptance and sue for the price, ratifying uses within the contractually authorized district, but also sue for infringement as to uses or distribution outside the contract terms.

4. *Delivery in Stages.* Subsection (c) deals with an important setting in computer information transactions - an agreement in which the intended final product is delivered and accepted in segments or modules. This is not an installment contract where the modules are and will remain separate, but a delivery in stages of a single information product. In such cases, acceptance of each module is a separate event, but this subsection provides as a default rule that each acceptance is implicitly conditional on the eventual acceptance of the whole. While this rule can be varied by contrary agreement, it represents the most likely expectation of the parties in such on-going development contexts.

2-610. Anticipatory Repudiation.

When either party repudiates the contract with respect to a performance not yet due the loss of which will substantially impair the value of the contract to the other, the aggrieved party may

(a) for a commercially reasonable time await performance by the repudiating party; or

(b) resort to any remedy for breach (Section 2-703 or Section 2-711), even though he has notified the repudiating party that he would await the latter's performance and has urged retraction; and

(c) in either case suspend his own performance or proceed in accordance with the provisions of this Article on the seller's right to identify goods to the contract notwithstanding breach or to salvage unfinished goods (Section 2-704).

EFFECT OF ACCEPTANCE.

Uniform Law Source: Uniform Commercial Code: Sections 2-606; 2-607(2); 2A-515 (1998 Official Text).

Definitional Cross References: Section 102: "Agreement"; "Cancel"; "Contract"; "Copy"; "Deliver"; "Knowledge"; "Notice"; "Notify"; "Party"; "Seasonably"; "Receive". Section 114: "Reasonable time." Section 701: "Breach".

Official Comments:

1. *Scope of the Section.* This section deals with the effect of acceptance of a copy. It derives from Article 2 and Article 2A of the Uniform Commercial Code (1998 Official Text) with changes reflecting the nature of computer information.

2. *General Effect of Acceptance.* Acceptance of a copy is the reverse of refusing the copy. As with acceptance of any performance, acceptance obligates the accepting party to pay and render any other agreed performance with respect to that copy. Generally, however, as indicated in subsection (a), unless acceptance occurs with knowledge of a defect under circumstances causing a waiver, acceptance of a copy does not alter the accepting party's remedies. Ordinarily, if there is a material, undiscovered defect in the copy or the information, the licensee may have a right to revoke acceptance. Whether or not that is true, the licensee retains the right to sue for damages. The rule conforms to that in Article 2 and should be interpreted with that in mind.

3. *Burden of establishing."* A party that has accepted a copy and cannot or does not revoke that acceptance has the burden of establishing the breach. "Burden of establishing" has the meaning set

forth in niform Commercial Code Article 1, which is that the party must persuade the trier of fact that the existence of the fact (e.g., breach) is more probable than its non-existence.

3. *Notice of Breach.* Subsection (c)(1) follows Article 2 (1998 Official Text) and provides that the party accepting the copy must notify the other party of the defect within a reasonable time or be barred from any remedy. This is a rule of fairness, reflecting that the accepting party is in control of the copy and controls any issues with respect to it. It is also a rule of closure.

At some point, the other party is entitled to conclude that the transaction has reached a successful end. In the case of latent defects, the rule is that notice must be given within a reasonable time after the defect should have been discovered. If a defect is neither known nor knowable for an extended period, the reasonable time to notify extends from when it should have been discovered. What constitutes a reasonable time and to what extent it can be determined by agreement is discussed in Section 114.

2-611. Retraction of Anticipatory Repudiation.

(1) Until the repudiating party's next performance is due he can retract his repudiation unless the aggrieved party has since the repudiation cancelled or materially changed his position or otherwise indicated that he considers the repudiation final.

(2) Retraction may be by any method which clearly indicates to the aggrieved party that the repudiating party intends to perform, but must include any assurance justifiably demanded under the provisions of this Article (Section 2-609).

(3) Retraction reinstates the repudiating party's rights under the contract with due excuse and allowance to the aggrieved party for any delay occasioned by the repudiation.

ACCESS CONTRACTS.

Definitional Cross Reference: Section 102: "Access contract"; "Agreement"; "Contract"; "Contractual use term"; "Information"; "Informational Rights"; "License"; "Licensee"; "Licensor"; "Person"; "Software"; "Term".

Official Comments:

1. *Scope of the Section.* This section establishes default rules for access contracts.

2. *Nature of an Access Contract.* There are several types of access contracts. In one, access and agreement occur at the same time; there is no on-going relationship. This kind of access contract is like visiting a store: assuming a contract is made, the customer is bound by the contractual rules in effect on the date of the visit. There is no continuing contract or relationship – if the customer visits the store again or obtains access again, the new visit is not part of the prior contract.

In a second, a continuous access contract, the licensee has a contractual right to access at times of its own choosing within periods of agreed availability or at times established in the contract. This relationship occurs in on-line services that operate on a subscription or membership basis. The typical agreement is not only that the transferee receives the access or information, but that resource be accessible on a continuing basis.

A continuous access contract is unlike installment contracts under Article 2 of the Uniform Commercial Code, which are segmented into multiple tender-acceptance sequences. In continuing access contracts, a licensor merely keeps the system available for the licensee to access when it chooses (assuming the contract does not restrict access to specified hours or days). This is a modern application of traditional concepts of licensed use of resources applied to electronic contexts.

3. *Basic Obligations.* The basic obligation in a continuous access contract is to keep the system available in a manner consistent with contract terms and industry practices.

a. Content Changes. Absent agreement to the contrary, an access contract does not bind the licensor to holding available particular computer information. Access is granted to the information or other resources provided as they exist at the time of the particular access. Databases may be added, modified or deleted consistent with this core obligation. Paragraph (a)(1) recognizes that. However, if the agreement was to make available specific information as indicated in an express term of the agreement, removing that information may breach the contract under paragraph (a)(2)..

b. General Standards of Availability. As indicated in subsection (a)(4), availability is subject to contract terms, but in the absence of such, the appropriate reference is to general standards of the industry involving the particular type of transaction. A contract involving access to a news and information service would have different accessibility expectations than would a contract to provide remote access to systems for processing air traffic control data. See *Reuters Ltd. v. UPI, Inc.*, 903 F.2d 904 (2d Cir. 1990); *Kaplan v. Cablevision of Pa., Inc.*, 448 Pa. Super. 306, 671 A.2d 716 (Pa. Super. 1996).

c. Use of Received Information. The access contract may or may not contain terms that restrict use of the information obtained. If there are no restrictions in the agreement, subsection (a)(3) indicates that the information is received on an unrestricted basis, subject to intellectual property rights and any separate agreement concerning that information. For example, if an access contract enables access to news articles, but does not limit their use by the licensee, no limit exists other than under copyright or other applicable law (e.g., publicity rights).

In contrast, if the access contract or a separate agreement place limitations on use of information obtained, those license terms would be governed under this Act. They are interpreted and enforced pursuant to other provisions of this Act and, of course, the terms of the agreement. Once information is received by the licensee, it is ordinarily no longer appropriate to treat the relationship as an access contract, but it is simply a license.

For example, if licensee uses the access provided by its contract with ABC Corporation to acquire a copy of a spreadsheet program, when the program is received by the licensee, the rights and remedies of the parties with respect to use of the program are governed by the agreement with respect to that program and, in the absence of agreed terms, by the default rules of this Act regarding software licenses. As to the software, the relationship ceased to be an access contract when the software was received by the licensee. The terms of the license may be found in the agreement establishing the access contract or in a separate agreement concerning the licensed information.

Restrictions are not necessarily based on a license. In some cases, a copyright notice restricts use of the information obtained through on-line access. *Storm Impact, Inc. v. Software of the Month Club*, 13 F.Supp.2d 782 (N.D. Ill. 1998) (on-screen limitation precluding commercial use of software enforced; court did not clarify whether the notice was a license or merely limited permission granted by posting the software on the Internet).

4. *Downtime.* Subsection (b) indicates that, unless the agreement provides otherwise, occasional unavailability is expected as part of contracts of this type. Of course, this can be altered by agreement. Subsection (b) provides several common situations in which unavailability can be expected; subsection (b)(2)(A) focuses on scheduled unavailability such as a period during which online activity may be suspended during a scheduled reconciliation of online account activity.

2-612. "Installment contract"; Breach.

(1) An "installment contract" is one which requires or authorizes the delivery of goods in separate lots to be separately accepted, even though the contract contains a clause "each delivery is a separate contract" or its equivalent.

(2) The buyer may reject any installment which is non-conforming if the non-conformity substantially impairs the value of that installment and cannot be cured or if the non-conformity is a defect in the required documents; but if the non-conformity does not fall within subsection (3) and the seller gives adequate assurance of its cure the buyer must accept that installment.

(3) Whenever non-conformity or default with respect to one or more installments substantially impairs the value of the whole contract there is a breach of the whole. But the aggrieved party reinstates the contract if he accepts a non-conforming installment without seasonably notifying of cancellation or if he brings an action with respect only to past installments or demands performance as to future installments.

CORRECTION AND SUPPORT AGREEMENTS.

Uniform Law Source: Restatement (Second) of Torts § 299A. Revised.

Definitional Cross References: Section 102: "Agreement"; "Contract"; "Information"; "Licensee"; "Licensor"; "Person"; "Term".

Official Comments:

1. *Scope of the Section.* This section concerns agreements to correct performance problems (subsection (a)) or to provide support for the use of computer information (subsection (b)). The rules here are default rules that may be varied by agreement..

2. *Nature of Obligation to Correct Problems.* Obligations under agreements to correct performance problems differ from an obligation to provide updates or new versions of software or to cure warranty breaches. These are contracts where a vendor agrees to be available to attempt to correct problems in software for a fee. The contract is analogous to a maintenance or repair contract for goods. An agreement to provide updates or new versions, on the other hand, is like an installment contract to deliver new versions as developed and made available. New versions may cure problems in earlier versions, but an update agreement deals with new products, while a maintenance contract entails

correcting problems in an older product. The standards by which the distinction is made focus on the factual context, the terms of the agreement, and general industry standards.

3. *Services Obligation.* Most agreements to correct performance problems are services contracts. The contract obligation is stated in subsection (a)(1). It parallels the obligation that a services provider undertakes: a duty to act consistently with the standards of the business to complete the task. A services provider does not guaranty that its services will yield a perfect result, but rather that its performance will be characterized by a particular quality and effort. This section measures that by reference to standards of the relevant trade or industry.

4. *Services in Lieu of Warranty.* In some cases, an agreement to correct performance problems is part of a limited remedy or warranty and the promissor agrees to a particular outcome. The prototype is a limited express warranty created a duty to "repair" the defective product. The agreements are under subsection (a)(2). In these cases, the obligation is to repair the product such that it conforms to the contract. What performance conforms to the general contract to which the remedy relates, of course, hinges on the terms of that agreement as interpreted in light of usage of trade, course of performance and the like. If the performance fails to yield a conforming product, the remedy for that failure depends on other terms of the agreement (such as any right to provide a refund as an alternative to repair or replacement options) and the rules in this Act.

5. *Support Agreements.* A support agreement is an agreement to make available advice or consulting services relating to the information. Subsection (b) provides a default rule regarding support agreements. As a form of services contract, the appropriate standard is an obligation consistent with reasonable standards of the industry.

2-613. Casualty to Identified Goods.

Where the contract requires for its performance goods identified when the contract is made, and the goods suffer casualty without fault of either party before the risk of loss passes to the buyer, or in a proper case under a "no arrival, no sale" term (Section 2-324) then

(a) if the loss is total the contract is avoided; and

(b) if the loss is partial or the goods have so deteriorated as no longer to conform to the contract the buyer may nevertheless demand inspection and at his option either treat the contract as avoided or accept the goods with due allowance from the contract price for the deterioration or the deficiency in quantity but without further right against the seller.

CONTRACTS INVOLVING PUBLISHERS, DEALERS, AND END USERS.

Definitional Cross References. Section 102: "Agreement"; "Contract"; "Copy"; "Delivery"; "Information"; "Informational rights"; "License"; "Licensee"; "Licensor"; "Merchant"; "Party"; "Person"; "Receive"; "Return"; "Term".

Official Comments:

1. *Scope of the Section.* This section deals with three-party retail relationships involving a publisher, dealer, and end user. The section only applies to retail distribution of physical copies. See Section 102(46) for a discussion of retail.

2. *Parties.* Subsection (a) contains three definitions that apply solely within this section. A "dealer" is essentially the retailer or other distributor that receives information for redistribution, e.g., a store that stocks its shelves with computer information products. The "end user" is the end-customer at reatil, i.e., the consumer or other person who acquires for use (as opposed to re-distribution) a copy of the information from the Store. A "publisher' is a licensor other than the dealer, e.g., the copyright owner who licensed the dealer to distribute the information. If a licensor of a word processing program distributes physical copies to Store for acquisition by consumers, the licensor would be the "publisher", the Store would be the "dealer" and the consumer would be the "end user."

3. *Dealer and End User.* Subsection (b) addresses the dealer's relationship with the end user. While in the cases considered in this section, the end user acquires the copy from the dealer, whether the dealer has authority to grant a right to use the work under copyright or other law is determined by its contract with the publisher. In many retail distribution systems, that contract allows distribution only under specified conditions, which may include a requirement that the distribution and the end user's rights are subject to a publisher's license with the end user.

Unlike in distribution of goods by sale, under copyright law, the end user's rights to use the copy (i.e., to allow his computer to make copies of the information in order to use the copy) do not flow simply from delivery of the copy to it, but depend on the dealer's compliance with the distribution license. *Microsoft Corp. v. Harmony Computers & Electronics, Inc.*, 846 F. Supp. 208 (ED NY 1994). This is because, for example, the rights to make copies and distribute copies are exclusive rights of the copyright owner (the publisher) and are only conditionally licensed to the dealer.

Subsection (b) deals with the common situation in which the end user's right to use the copy depends on a license from the publisher to the end user. It thus does not concern a case where the publisher sold or authorized sale of copies not subject to a license. In the cases to which it applies, however, subsection (b) provides a basis to reconcile the position of the three parties which protects insofar as possible, the retail expectations of the end user.

a. Contracts Separable. Under paragraph (b)(3), the dealer is not bound by, nor does it benefit from any contract created by the publisher with the end user unless the dealer and end user adopt those terms as part of **their** agreement. This follows case law on manufacturer warranties and warranty limitations in other contexts, although that rule has been over-ridden in some states. See Cal. Civ. Code § 1791 ("as is" disclaimer disclaims warranties for manufacturer, distributor and retailer-dealer). Because the agreements are separate, warranties or other obligations of a dealer are not affected (reduced or expanded) if the publisher's license is accepted by the end user. The dealer is bound by its contract with the publisher.

b. Dealer as Licensor. Subsection (d) confirms that the dealer is a licensor with respect to the end user. It may have contractual obligations under this Act flowing from its own agreement with the end user. This corresponds to ordinary retail expectations; the retailer is not viewed as nothing more than a conduit with respect to recovery of the price in the event of default. As a result, in effect, the end user licensee may have separate recourse against two different parties (the dealer and, if it agrees to the license, the publisher).

c. Conditional Rights. Under subsection (b)(1) and (b)(2), the dealer's relationship with the end user hinges on the end user's ability to use the information supplied by the dealer. This depends on the license between the publisher and the end user. If the end user declines that license, it has a right to obtain a refund from, or to cancel payment to, the dealer. This creates a return *right*, rather than merely an option.

An alternative view of the relationship, which is not precluded by the section if it is created by the agreement of the parties, treats the publisher's license as part of the dealer's contract which the end user and dealer understood from the outset would be provided to complete the entire terms of the relationship. This is an application of the right, long recognized in commercial law, of parties to make a contract leaving it to one party to supply particulars of performance after the initial agreement, with the specifications here coming in the form of a publisher's license.

Where the arrangement is that assent to these later particulars is required and the end user rejects the terms, it in effect is also rejecting the contract with the dealer and is entitled to return the copy and receive a refund. Agreement here, as in other respects, does not depend solely on express terms, but can be found or inferred from the circumstances surrounding the contracting, applicable usage of the trade, in course of dealing and the like.

4. *Dealer and Publisher.* Often the publisher's arrangement with the dealer is a license that retains ownership of copies in the publisher and permits distribution only subject to an end user license. The legislative history of the Copyright Act indicates that, whether or not there was a sale of the copy, contractual restrictions on use are appropriate under contract law. "[The] outright sale of an authorized copy of a book frees it from any *copyright* control over … its future disposition…. This does not mean that conditions … imposed by contract between the buyer and seller would be unenforceable between the parties as a breach of contract, but it does mean that they could not be enforced by an action for infringement of copyright." H.R. Rep. No. 1476, 94th Cong., 2d Sess. 79 (1976). See also *DSC Communications v. Pulse Communications*, 170 F.3d 1354 (Fed. Cir. 1999).

2-614. Substituted Performance.

(1) Where without fault of either party the agreed berthing, loading, or unloading facilities fail or an agreed type of carrier becomes unavailable or the agreed manner of delivery otherwise becomes commercially impracticable but a commercially reasonable substitute is available, such substitute performance must be tendered and accepted.

(2) If the agreed means or manner of payment fails because of domestic or foreign governmental regulation, the seller may withhold or stop delivery unless the buyer provides a means or manner of payment which is commercially a substantial equivalent. If delivery has already been taken, payment by the means or in the manner provided by the regulation discharges the buyer's obligation unless the regulation is discriminatory, oppressive or predatory.

RISK OF LOSS OF COPY.

Uniform Law Source: Uniform Commercial Code: Section 2-509 (1998 Official Text). Revised.

Definitional Cross References: Section 102: "Contract"; "Copy"; "Delivery"; "Licensee"; "Licensor"; "Party"; "Record"; "Receive"; "Send". Uniform Commercial Code: "Document of title": Section 1-201.

Official Comments:

1. *Scope of the Section.* This section applies to risk of loss with respect to copies; it does not apply to access contracts and does not deal with other risks of loss, such as loss of the information itself or of informational rights. The section focuses on risk of loss; it does not alter rules of this Act about passage of title or tender of delivery. Each of these operate independently.

2. *Basic Approach.* This section follows Article 2 of the Uniform Commercial Code (1998 Official Text): which party bears the risk of loss is determined by the agreement and, in the absence of agreement, by standards that focus on the transaction rather than on title to copies or tender of delivery. This is a default rule subject to variation by agreement. Agreement may be found in express terms, course of dealing, usage of trade or inferred from the circumstances of the contracting. Absent contrary agreement, as between licensor and licensee, risk of loss lies with the person in possession or control of the copy. It passes from one party to the other on receipt of the copy or control of it, unless another rule governs under this section or the agreement.

3. *Electronic Transfer.* If a copy is transferred electronically, risk of loss passes to the recipient when the copy is received. Subsection (a). The recipient should have no risk regarding the loss of a copy that has not yet been received where electronic transmissions are, in effect, virtually instantaneous. This rule places the risk of a loss that occurs during transmission on the sender and assumes that the transferor who sends the copy electronically also retains a copy that could be used for retransmission. This rule for electronic transfers of copies compares to the rule for delivery of tangible copies. It does not concern issues about when tender of delivery occurs which, in most cases is on delivery to a carrier or electronic transmission.

4. *Delivery of Physical Copies.* Subsection (b) deals with transactions in which the transfer of the copy is of a tangible copy to be shipped. The rules of this section are from U.C.C. Article 2 (1998 Official Text) and correspond to when a tender of delivery occurs. They distinguish between a shipment contract (Section 606(b)(2)) and a destination contract (Section 606(b)(3)). Most shipments of tangible copies involve shipment contracts, but the agreement controls. "Duly delivered" in the case of a shipment contract requires that the sender tender the copy to the carrier pursuant to an appropriate contract with the carrier.

5. *Delivery without Moving the Copy.* Subsection (c) states rules regarding transfers accomplished without moving a copy. It transfers risk of loss when the transferee receives the ability to control the copy or when it receives access materials to access the copy. These rules correspond to U.C.C. Article 2 (1998 Official Text) but are updated for cases where the transaction entails electronic access from which a copy can be obtained.

2-615. Excuse by Failure of Presupposed Conditions.

Except so far as a seller may have assumed a greater obligation and subject to the preceding section on substituted performance:

(a) Delay in delivery or non-delivery in whole or in part by a seller that complies with paragraphs (b) and (c) is not a breach of his duty under a contract for sale if performance as agreed has been made impracticable by the occurrence of a contingency the non-occurrence of which was a basic assumption on which the contract was made or by compliance in good faith with any applicable foreign or domestic governmental regulation or order whether or not it later proves to be invalid.

(b) Where the causes mentioned in paragraph (a) affect only a part of the seller's capacity to perform, he must allocate production and deliveries among his customers but may at his option include regular customers not then under contract as well as his own requirements for further manufacture. He may so allocate in any manner which is fair and reasonable.

(c) The seller must notify the buyer seasonably that there will be delay or non-delivery and, when allocation is required under paragraph (b), of the estimated quota thus made available for the buyer.

EXCUSE BY FAILURE OF PRESUPPOSED CONDITIONS.

Uniform Law Source: Uniform Commercial Code: Sections 2A-405, 2A-406; 2-615, 2-616 (1998 Official Text).

Definitional Cross References: Section 102: "Agreement"; "Copy"; "Contract"; "Contractual use terms"; "Delivery"; "Good faith"; "Notice"; "Notify"; "Party"; "Receive"; "Record"; "Seasonable;" "Terminate." Section 114: "Reasonable time."

Official Comments:

1. *Scope of the Section.* This section adopts the formulation of impossibility doctrine in Uniform Commercial Code Article 2 (1998 Official Text). However, the doctrine is made applicable to both parties.

2. *Nature of Excuse.* Subsection (a) conforms to Article 2-615 of the Uniform Commercial Code (1998 Official Text) and intends to adopt the decisions and policies reflected under that section. A party is excused from timely performance of a contractual obligation if that performance becomes commercially impracticable because of unforeseen supervening events not within the contemplation of the parties at the time of contracting. The standard of excuse in this section does not apply to an obligation to pay or conform to use restrictions. This does not displace general law on the effect of governmental regulations as an excuse for the obligation of payment.

The section merely does not address that issue, leaving its resolution to general common law. Increased cost does not excuse performance unless the increase is due to an unforeseen contingency that alters the essential nature of the performance obligation and that cannot reasonably be viewed as within the contingencies that were foreseeable in the original agreement. A rise or a fall in the market or market prices is not in itself a justification. Market and cost fluctuations are the type of business risk which commercial contracts cover.

Similarly, if the agreement calls for development of new technology, no excuse arises if the agreed development itself proves to be technologically impossible or excessively costly. That risk is inherent in a development agreement and is assumed to be allocated in the basic contract. However, if both parties proceeded on the assumption that a third party technology would be completed, but this does not occur and renders the project impossible, the agreement may have been based on an assumed fact or occurrence that did not ensue and an excuse may be appropriate.

Excuse doctrine does not apply if, under the agreement, the party seeking to claim an excuse agreed to assume the risk of the contingency that occurred. Such agreement can be found not only in express terms of the contract, but in the circumstances of the contracting, trade usage, course of dealing and the like. The exemptions of this section do not apply when the contingency in question is sufficiently foreshadowed at the time of contracting to be included among the business risks which are fairly to be regarded as part of the contract terms, either consciously or as a matter of reasonable commercial interpretation from the circumstances.

3. *Notice.* Subsection (b) states a basic rule of fairness, requiring seasonable notice to the other party who will be affected by the performance deficiency caused by the excuse.

4. *Allocation Rules.* Subsections (c) and (d) are allocation rules based on Article 2 and limited to cases involving a contractual obligation to deliver copies. Under subsection (c), the licensor is required to make an allocation of the copies available for delivery among its customers and its own requirements. A licensor that has a partial excuse under this section must fulfill its contract to the extent that the over-riding contingency permits.

If the events affect its ability to supply its customers generally, this section allows the licensor to take into account the needs of all customers and of itself when fulfilling its obligation to one customer as far as possible. This may include customers not then under contract. However, good faith requires that the licensor exercise care in making allocations and, in cases of doubt, current contract customers should generally be favored. Except for such considerations, however, the standard here is intended to leave open reasonable business leeway to the licensor.

4*. Rights of Other Party.* The interests of a party faced with a material or indefinite delay are protected in subsection (d). The party may either accept the proposed allocation or treat the contract as terminated as to executory obligations. The latter option does not allow treating the case as involving a breach, but merely permits termination. If the party fails timely to accept the proposed modification, under subsection (e), the contract lapses as to the relevant performance.

2-616. Procedure on Notice Claiming Excuse.

(1) Where the buyer receives notification of a material or indefinite delay or an allocation justified under the preceding section he may by written notification to the seller as to any delivery concerned, and where the prospective deficiency substantially impairs the value of the whole contract under the provisions of this Article relating to breach of installment contracts (Section 2-612), then also as to the whole,

(a) terminate and thereby discharge any unexecuted portion of the contract; or

(b) modify the contract by agreeing to take his available quota in substitution.

(2) If after receipt of such notification from the seller the buyer fails so to modify the contract within a reasonable time not exceeding thirty days the contract lapses with respect to any deliveries affected.

(3) The provisions of this section may not be negated by agreement except in so far as the seller has assumed a greater obligation under the preceding section.s

TERMINATION; SURVIVAL OF OBLIGATIONS.

Uniform Law Source: Uniform Commercial Code: Sections 2A-505(2); 2-106(3) (1998 Official Text).

Definitional Cross References. Section 102: "Agreement"; "Contract"; "Contractual use term"; "Copy"; "Information"; "License"; "Party"; "Receive"; "Record"; "Remedy"; "Term"; "Termination".

Official Comments:

1. *Scope of the Section.* Termination means ending a contract other than for breach. This section describes the effect of termination and gives a partial list of obligations that survive termination unless otherwise agreed. The list is not exclusive.

2. *Effect of Termination.* Termination discharges *executory* obligations. It does not terminate vested rights or remedies.

3. *Executory Obligations.* An executory obligation is one that is not fully performed on both sides. If the prior performance of one party earned a reciprocal performance (e.g., payment or delivery) from the other, the discharge that occurs from termination does not affect that earned obligation. If the obligations of one or both parties are partly, but not fully completed, the basic rule is that an obligation is executory for purposes of this section if it is not fully performed and the unperformed part is such that a failure to perform it would be a material breach that excuses the other party's contractual obligation to perform. Minor remaining acts typically would not leave an obligation executory, but material remaining performance does.

4. *Survival Rules.* Subsection (b) lists terms and rights that survive termination. The list presumes that the obligation was created in the agreement and identifies terms that parties ordinarily would designate as surviving. The intent of this list is to provide background rules, reducing the need for specification in the contract. Of course, the parties may delete or add terms by agreement, which agreement can be found in the express terms of the contract or in the circumstances surrounding the contracting, in trade usage, in course of dealing and the like. Upon termination, various other rights may be vested and not executory: these also survive by application of the standard in subsection (a).

2-617. NOTICE OF TERMINATION.

Uniform Law Source: Uniform Commercial Code Section 2-309(c) (1998 Official Text).

Definitional Cross References. Section 102: "Access contract"; "Contract"; "Information"; "Licensee"; "Licensor"; "Give notice"; "Party"; "Term"; "Termination".

Official Comments:

1. *Scope of the Section.* This section deals with when notice of termination is required; it does not deal with when a contract may be terminated. The rules here do not apply to cancellation for breach.

2. *Termination on the Happening of an Event.* No notice is required for termination based on an agreed event (e.g., the end of the stated license term). This follows Article 2 of the Uniform Commercial Code (1998 Official Text) and common law. The parties are charged with awareness of agreed terms; in cases covered by this rule, they agreed that the contract would expire on the happening of an objectively ascertainable event. No notice is needed when this event occurs.

3. *Notice in Other Cases.* Except as stated in subsection (b), termination based on discretion of one party (such as an "at will termination") requires that reasonable notice be given. What is notice is reasonable varies with the circumstances. For example, where the reason for termination involves unlawful conduct or a desire to prevent harmful acts, notice at or promptly after termination may suffice. In less exigent or harmful circumstances, giving prior notice ordinarily may be required. A function of the notice requirement when there are no exigent circumstances and there is no material breach that would justify cancellation, is to give the other party an opportunity to make other arrangements and to avoid use of the information after termination in a way that may result in further breach of contract or infringement of intellectual property rights.

The party terminating the contract must give notice. A requirement that notice be received would create uncertainty that is undesirable where the terminating party is merely exercising a contractual right. The uncertainty is especially great in online situations where the current or actual location of many users may be difficult or impossible to ascertain.

4. *Access Contracts.* Under subsection (c), termination of access in an access contract does not require notice even if based on exercise of discretion by the terminating party . Of course, termination must be allowed by the contract. An access contract gives contractual rights to access a resource owned or controlled by the licensor. When the contract terminates, the access privilege terminates. This rule is consistent with prior law for licenses of this type, although in many cases, a license to use resources or property of the licensor is subject to termination at will without notice. This section provides a limited exception to the common law rule and applies when the access contract involves information that is provided to the licensor and owned by the licensee, such as when a licensee has

provided its employee list for storage on a computer of the licensor that is accessed under license to the licensee. What is meant here is ownership of the information. Thus if a customer provides information to effect a purchase, the customer transactional information is typically not owned by the customer to whom it refers and the exception does not apply.

5. *Contract Modification.* Subsection (c) corresponds to U.C.C. Article 2 (1998 Official Text). Under subsection (c), a notice requirement may be waived or the terms, timing and other aspects of notice may be specified by agreement. The subsection places two restrictions on this contract principle.

a. First, an agreed waiver of notice is enforceable only enforcement of the term is not unconscionable. This rule permits contractual waivers of notice, but allows a court to police exercise of the right thus created if that exercise is unconscionable. The focus is not on the term in this context, but on its operation. This rule does not apply where the agreement sets standards for notice of termination.

b. Second. standards set by agreement for notice of termination are enforceable unless they are manifestly unreasonable. This rule permits flexibility in an agreement, but allows a court to reject clearly abusive terms. It does not allow invalidation simply because application of the standard causes an undesirable result when viewed in retrospect.

2-618. TERMINATION: ENFORCEMENT.

Definitional Cross References. Section 102: "Copy"; "Contract"; "Court"; "Electronic"; "Information"; "Informational Rights"; "License"; "Licensee"; "Party"; "Person"; "Term"; "Termination".

Official Comments:

1. *Scope of the Section.* This section deals with obligations arising on termination of a license and winding down the relationship. The section does not deal with cancellation for breach or with transactions other than a license. For cancellation, see Sections 802, 815 and 816.

2. *Obligation to Return.* Subsection (a) states the unexceptional principle that, on termination of a license, a party (licensor or licensee) is entitled to return of any materials that it owns or that the contract requires to be delivered at the end of the relationship. This is a contract right. The obligation is to use commercially reasonable efforts. In some cases, circumstances may prevent or delay a their return. A reasonable effort, however, does not encompass intentional or knowing retention of copies. Similarly, it is subject to subsection (b) which makes clear that use of the information after the contract terminates is a breach of contract.

3. *Terminating Rights of Use.* Termination of the license ends all rights of use pursuant to the license except those rights that by agreement survive or are irrevocable. This rule corresponds to prior law and reflects the conditional nature of the rights established under a license. Continued use not authorized by the license after termination breach the contract. If intellectual property rights are involved, such use may also be an infringement. Since termination does not entail actions in response to a breach of contract, no provision is made for limited use to mitigate damages. Compare Section 802.

Uses referred to here relate to use of the licensed copy or information. If a licensee obtains a new license, or obtains the same information from other persons, the right to use this information does not depend on the original license and is not covered by this section.

4. *Enforcement.* Subsection (c) provides for judicial enforcement of termination rights if the parties do not timely comply with their obligations when the contract ends.

PART 7. REMEDIES [Table of Contents]

2-701. Remedies for Breach of Collateral contracts Not Impaired.

Remedies for breach of any obligation or promise collateral or ancillary to a contract for sale are not impaired by the provisions of this Article.

BREACH OF CONTRACT; MATERIAL BREACH.

Uniform Law Source: Restatement (Second) Contracts § 241(1998 Official Text).

Definitional Cross References: Section 102: "Aggrieved party"; "Agreement"; "Contract"; "Contractual use term"; "Party"; "Term".

Official Comments:

1. *Scope of Section.* This section defines a breach of contract and provides standards to distinguish between material and non-material breach.

2. *Material Breach and non-material Breach.* This Act follows common law. A party's contractual remedies are determined by whether a breach is material or immaterial. Both types of breach entitle the aggrieved party to remedies, but a material breach gives a right to cancel the contract.

2. *What is a Breach?* What is a breach is determined by the agreement or, in the absence of agreement, this Act. A party must conform to the contract. A breach occurs if a party acts in a manner that violates the agreement or fails to act in a manner required by the contract. This includes but is not limited to a failure timely to perform, a breach of warranty, a repudiation, non-delivery, wrongful disclosure, uses in violation of the contract, exceeding contract limits, and other breaches.

3. *What is a material breach?* This Act adopts the rule followed in common law and international law. Parties are entitled to the performance for which they bargain, but some breaches are so immaterial that they do not justify allowing cancellation of the entire contract. In such cases, it is better to preserve a contract despite minor problems than to allow one party to cancel for minor defects and thereby risk an unwarranted forfeiture or allow unfair opportunism.

Materiality depends on the agreement or, failing that, the circumstances. A failure fully to conform to promises about the capability of software to handle 10,000 files may not be material if the licensee's use will never exceed 4,000 files and the software is able to handle 9,000 files. Materiality is judged from the aggrieved party's perspective in light of the nature of the bargain and the benefits expected from performance of the contract.

A statute cannot define materiality with precision, but can give appropriate reference points. Subsection (b) provides three reference points: contract terms defining materiality, a substantial failure to perform an essential term, and a breach causing substantial harm to the aggrieved party or a denial of a reasonably expected significant benefit. This last consideration, of course, refers to substantiality in context of the agreement itself. Thus, in a contract for a ten dollar software license, a breach causing ten dollars of harm would be material even though, in thirty million dollar license, a ten dollar loss would likely be non-material.

The list in subsection (b) is not exclusive. This section should be interpreted in light of common law and the *Restatement*. See *Rano v. Sipa Press*, 987 F.2d 580 (9th Cir. 1993); *Otto Preminger Films, Ltd. v. Quintex Entertainment, Ltd.*, 950 F.2d 1492 (9th Cir. 1991). Common law concepts generally preclude unreasonable forfeiture of interests for minor defalcations; thus in the absence of agreement about a term, materiality hinges on substantial denial to the aggrieved party of the advantages (consideration) it sought from the transaction.

The *Restatement (Second) of Contracts* § 241 (1981) lists five factors: 1) the extent to which the injured party will be deprived of the benefit he or she reasonably expected; 2) the extent to which the injured party can be adequately compensated for the benefit of which the party will be deprived; 3) the extent to which the party failing to perform or to offer to perform will suffer forfeiture; 4) the likelihood that the party failing to perform or to offer to perform will cure the failure, taking into account all the circumstances, including any reasonable assurances; and 5) the extent to which the behavior of the party failing to perform or to offer to perform comports with standards of good faith and fair dealing.

4. *Contract Terms.* The agreement defines what is a material breach in two ways. The first is by express terms that either give a right to cancel for a particular breach or provide that a particular type of breach is material. Of course, a court must reasonably interpret that agreement. Thus, a term providing that *any* failure to conform to *any* contract term permits cancellation must be interpreted in light of commercial context that includes usage of trade, course of performance, or course of dealing. Section 113(b).

That context may indicate that minor breach of some terms are nonetheless not adequate for cancellation. The second method involves enforcing express conditions. If a contract indicates that conforming to a specific requirement is a precondition to the performance of the other party, that condition should be enforced. The express condition defines part of the remedy: breach allows the aggrieved party to not perform simply because the express condition for its performance is not met.

Illustration: In a software development contract, the contract expressly conditions acceptance of the product on its meeting ten conditions. One condition is that it must operate at "no less than 150,000 rev. per second." The software does not meet that condition. Failure to meet the condition justifies refusal of the product.

5. *What Remedies Apply?* If a party's performance breaches the contract, the aggrieved party is entitled to its remedies. The remedies available depend on the nature of the breach. All remedies are generally available for material or non-material breach, except the remedy of cancellation. The aggrieved party can cancel the contract only if the breach was material. For either type of breach, there is an intermediate remedy in that a party whose expectations of future performance are

impaired may suspend performance and demand adequate assurance of future performance from the other. Section 708.

2-702. Seller's Remedies on Discovery of Buyer's Insolvency.

(1) Where the seller discovers the buyer to be insolvent he may refuse delivery except for cash including payment for all goods theretofore delivered under the contract, and stop delivery under this Article (Section 2-705).

(2) Where the seller discovers that the buyer has received goods on credit while insolvent, the seller may reclaim the goods upon demand made within a reasonable time after the buyer's receipt of the goods. Except as provided in this subsection, the seller may not base a right to reclaim goods on the buyer's fraudulent or innocent misrepresentation of solvency or of intent to pay.

(3) The seller's right to reclaim under subsection (2) is subject to the rights of a buyer in ordinary course of business or other good -faith purchaser for value under Section 2-403. Successful reclamation of goods excludes all other remedies with respect to them.

WAIVER OF REMEDY FOR BREACH OF CONTRACT.

Uniform Law Sources: Uniform Commercial Code: Sections 1-207; 2A-107; 2-607 (1998 Official Text).

Definitional Cross References**:** Section 102: "Aggrieved Party"; "Authenticate"; "Contract"; "Knowledge"; "Merchant"; "Notice"; "Notify" ("give notice"); "Party"; "Receive"; "Record"; "Term"; "Seasonable". Section 112: "Manifest assent". Section 114: "Reasonable time."

Official Comments:

1. *Scope of the Section.* This section deals with waivers. A "waiver" is a voluntary relinquishment of a known right. The section brings together rules from common law and from Article 2 of the Uniform Commercial Code (1998 Official Text).

2 *Waivers in a Record.* Waivers made in a record to which a party agrees, including by a manifestation of assent, are enforceable without consideration. This follows modern law. See Uniform Commercial Code § 2A-207; *Restatement (Second) of Contracts* § 277. This rule in subsection (a) does not preclude other forms of waiver, but merely confirms that waivers within its provisions are effective. Oral waivers effective under common law remain effective under this Act.

3. *Waiver by Accepting a Performance.* Subsection (b) deals with waivers resulting from accepting a performance without objecting to known deficiencies in it. Waiver is implied from conduct and knowledge of the defect coupled with silence beyond a reasonable time. This type of waiver does not apply if the party merely knows a performance is not consistent with the contract. The defective performance must have been tendered to and accepted by that party. Failure to object to uses that violate a license but pertain to performance not delivered to the other party is not a waiver. In some cases, of course, it may result in an estoppel.

A party presented with deficient performance is not required to elect between accepting or entirely refusing it. Subsection (b) permits the party to preserve its rights by (1) giving notice of objection to the deficiency within a reasonable time; or accepting the performance and giving prior notice that it does so while reserving its rights. The first option comes from Article 2 of the Uniform Commercial Code (1998 Official Text). The second is from Article 1 of the Uniform Commercial Code (1998 Official Text). Of course, the party in appropriate cases may simply refuse the performance.

4. *Failure to Particularize.* Refusal of a performance does not place the refusing party at risk if it does not state reasons for its refusal. There is no requirement for the party to particularize the reasons for the refusal. Under subsection (c), however, a waiver results from a failure to particularize the reason for refusal if the other party could have cured the problem had it been seasonably given the the basis for refusal, or, between merchants, if the breaching party asks for a specification in a record of the reasons for refusal and a basis for refusal is not listed among the reasons. This follows Uniform Commercial Code § 2-605 (1998 Official Text). The rule is grounded in fairness: the aggrieved party is obligated to provide notice to the other party of defects reasonably known to the aggrieved party; but the aggrieved party does not waive defects that were later-discovered.

5. *Scope of Waiver.* Under subsection (d), absent express agreement or circumstances clearly indicating to the contrary, a waiver applies only to the specific breach waived and does not alter remedies for future breaches. This principle does not alter estoppel concepts; a waiver may create justifiable reliance as to future conduct in an appropriate case.

6. *Retracting a Waiver.* A waiver cannot be retracted with respect to the past events whose consequences are waived. This principle is especially important in the continuing relationships often evidenced by licenses. It allows and encourages aggrieved parties to waive particular defective

performances without forfeiting rights as to future performances, and thus supports an ongoing relationship.

Also, a waiver enforceable as to future events supported by consideration cannot be unilaterally retracted. Such waivers constitute a bilateral agreement. On the treatment of waivers supported by consideration, see *Restatement (Second) of Contracts* 84, comment f.

2-703. Seller's Remedies in General.

(1) A breach of contract by the buyer includes the buyer's wrongful rejection or wrongful attempt to revoke acceptance of goods, wrongful failure to perform a contractual obligation, failure to make a payment when due, and repudiation.

(2) If the buyer is in breach of contract the seller, to the extent provided for by this Act or other law, may:

(a) withhold delivery of such goods;

(b) stop delivery of the goods under Section 2-705;

(c) proceed under Section 2-704 with respect to goods unidentified to the contract or unfinished;

(d) reclaim the goods under Section 2-507(2) or 2-702(2);

(e) require payment directly from the buyer under Section 2-325(c);

(f) cancel;

(g) resell and recover damages under Section 2-706;

(h) recover damages for non-acceptance or repudiation under (Section 2-708(1) or in a proper case the price (Section 2-709);

(j) recover the price under Section 2-709;

(k) obtain specific performance under Section 2-716;

(l) recover liquidated damages under Section 2-718;

(m) in other cases, recover damages in any manner that is reasonable under the circumstances.

(3) If the buyer becomes insolvent, the seller may:

(a) withhold delivery under Section 2-702(1);

(b) stop delivery of the goods under Section 2-705;

(c) reclaim the goods under Section 2-702(2).

CURE OF BREACH OF CONTRACT.

Uniform Law Source: Uniform Commercial Code: Sections 2-508; 2A-513 (1998 Official Text)

Definitional Cross References. Section 102: "Aggrieved party"; "Cancellation"; "Contract"; "Copy"; "Direct damages"; "Good faith"; "License"; "Mass-market license"; "Notifies"; "Party"; "Receive"; "Seasonable". Section 114: "Reasonable time." Section 602: "Enable use". Section 701: "Material breach".

Official Comments:

1. *Scope of the Section.* This section recognizes an opportunity to cure a breach and retain a contractual relationship. For licensees, cure often relates to missed or delayed payments or failure to timely give a required accounting or other report. For licensors, the issues often focus on timeliness of performance and adequacy of product. The section sets limits on the opportunity to cure, reflecting a balance between a goal of preserving contract relationships and a goal of giving the injured party the full benefit of its agreement. Subsection (b) creates a new rule: a limited duty to cure in cases where the injured party was required to accept a copy because it was not a material breach as to that copy.

2. *General Idea of Cure.* The idea that a breaching party may preserve the contract if it acts promptly to eliminate the effect of breach is embedded in modern law. See *Restatement (Second) of Contracts* § 237. However, there is significant disagreement about the scope of allowed cure, reflecting different balances drawn between the policy of allowing a party to preserve a contractual relationship and policies that protect the valid expectations of the aggrieved party. Compare UNIDROIT *International Principles of Commercial Contract Law* art. 7.1.4; U.N. *Sales Convention on the International Sale of Goods* art. 48.

3. *Right to Cure.* This section generally allows cure if it is prompt and in the circumstances avoids harm to the aggrieved party. The cure is not an excuse for faulty performance, but rather an

opportunity to avoid loss and retain the benefits of the contract for both parties. Cure does not eliminate a right to recover damages, but prevents cancellation of the contract based on the cured breach.

A right to cure exists if the cure occurs before the time for performance expires under paragraph (a)(1). A party whose early actions created a breach has an opportunity to make a good tender within the contract time. What is the agreed time for performance is determined by the agreement at the time of performance, including any enforceable modifications.

Cure requires seasonable notice to the other party of an intent to cure. The closer that the time of the breach is to the contractual time for performance, the greater is the necessity for promptness in giving notice and completing the cure. What constitutes seasonable notice depends on the context, including the importance of the expected performance and the timing and difficulty of obtaining substitutes. The notice does not constitute cure. Cure only occurs when a conforming performance is tendered.

4. *Permissive Cure.* If the time for performance expired before cure, cure is permissive only. There are two circumstances in which cure is permitted.

a. Expectation that initial performance would be acceptable. Paragraph (a)(2) creates a rule that seeks to avoid injustice by reason of a surprise refusal of a performance. The party in breach has an opportunity to cure if it had "reasonable grounds to believe" that the original tender would be acceptable. Thus, payment of eighty percent of the amount due would create an opportunity to cure only if from prior performance, the tendering party had reason to believe that tender would be acceptable. Such reason can arise from prior course of dealing, course of performance or usage of trade, as well as the particular circumstances surrounding the contract.

The party is charged with knowledge of factors in a particular transaction which in common commercial understanding require strict compliance with contractual obligations, but can also rely on course of dealing and usage of trade regarding variation of performance unless these have been clearly refuted by the circumstances, including the terms of the agreement. If the other party gives notice either implicitly, through a clear course of dealing, or through agreement terms that strict performance is required, those indications control application of this section. Requirements in a standard form that are not consistent with trade usage or the prior course of dealing and are not called to the other party's attention may be inadequate to show that expectations consistent with the trade usage or course of dealing are unreasonable.

b. Cure subject to other person's actions. Outside of the settings described in paragraphs (a)1) and (a)(2), the opportunity to cure is limited by the aggrieved party's right to insist on performance. Paragraph (a)(3) allows cure, but is restricted by the limitation that the cure must occur before the aggrieved party cancels the contract. This places control in the aggrieved party. In the mass market and in other cases of contracts involving rights in a copy, refusal of the copy may be cancellation because the entire transaction focused on providing rights associated with a copy. In such cases, no special notice or words of cancellation are required. As indicated in subsection (c), the aggrieved party is not required to withhold cancellation simply because of a notice of intent to cure received from the other party: whether cancellation will occur before the cure still is within the control of the aggrieved party.

5. *What is a Cure.* Cure requires the completion of acts that put the aggrieved party in essentially the position that would have ensued on conforming performance. Cure requires a party to perform the contract obligation and to fully compensate for loss. Monetary compensation may be required, but money is a cure only if provided in addition to full performance, such as tender of a conforming copy or tender of a late payment with any required late payment charges. Cure does not occur merely because one party announces its intention to cure, even if that intention is held in good faith. Cure only occurs when or if the proposed compensatory and conforming actions are completed.

Some contract breaches cannot be cured. This is true, for example, if a party breaches a contract by publicly disclosing licensed trade secret information. In such cases, the damage done by breach cannot be reversed and the provisions for cure under this section are inapplicable. A similar condition may arise where the agreement demands performance on a specific date or hour, but the performing party materially fails to meet the deadline. Cure is an opportunity to avoid ending a contract relationship by bringing the performance into line with the other party's rightful expectations. It does not allow a breaching party to avoid the consequence of breaches that have significant irreversible effects.

6. *Effect of Cure.* Cure of a breach does not mean that the aggrieved party must accept without a remedy less than conforming conduct. The effect of cure is that a contract cannot be canceled based on the cured breach. The aggrieved party retains its remedies under the agreement or this Act.

7. *Duty to Cure.* Subsection (b) applies to cases outside the mass market where a licensee must accept a performance because there is no material breach even though a defect exists. It creates an obligation to attempt to cure. Failure to undertake the effort is a breach, but failure to correct the problem is not a breach. The obligation to attempt a cure is limited by proportionality.

No obligation arises if it would entail costs disproportionate to the direct damages caused by the nonconformity. Thus, for example, if a party delivers a one thousand name list for $500 that omits five non-material names that reduce the value of the list by a small amount, it has no obligation to cure if obtaining those additional names would be disproportionate to the direct damages. In such case, the proper remedy is the difference in value (if any) of the copy rendered and the performance promised.

2-704. Seller's Right to Identify Goods to the Contract Notwithstanding Breach or to Salvage Unfinished Goods.

(1) An aggrieved seller under the preceding section may

(a) identify to the contract conforming goods not already identified if at the time he learned of the breach they are in his possession or control;

(b) treat as the subject of resale goods which have demonstrably been intended for the particular contract even though those goods are unfinished.

(2) Where the goods are unfinished an aggrieved seller may in the exercise of reasonable commercial judgment for the purposes of avoiding loss and of effective realization either complete the manufacture and wholly identify the goods to the contract or cease manufacture and resell for scrap or salvage value or proceed in any other reasonable manner.

REFUSAL OF DEFECTIVE TENDER.

Uniform Law Source: Uniform Commercial Code Sections 2-601, 2-602, 2A-509 (1998 Official Text)..

Definitional Cross References. Section 102: Aggrieved party"; "Agreement"; "Cancel"; "Contract"; "Copy"; "Delivery"; "Licensee"; "Mass-market transaction"; "Notifies"; "Party". Section 114: "Reasonable time."

Official Comments:

1. *Scope of Section.* This section deals with refusal of copies. It does not refer to other types of performance. The right to refuse is subject to Sections 705, 706, and 610.

2. *Refusal of the Tender.* A party may accept or refuse a tender of a copy. Except as stated in subsection (b), this section adopts common law principles that refusing a proffered performance is appropriate only if the performance entails a material breach of the agreement as to that performance, in this case the copy.

Refusal is the converse of "acceptance." A decision to refuse a tender ordinarily requires refusal of all of the tender. However, a licensee may accept some commercial units in the tender and reject the rest, if the commercial units are separable in light of the contracted performance. For example, if the vendor tenders thirty copies and ten are defective, the commercial unit is the copy and the licensee can accept the twenty and refuse the remainder. On the other hand, tender of of a single program where ten modules are defective and thirty are not does not create multiple commercial units and must be refused in whole or not at all. This section thus does not permit a party to disassemble an integrated or composite product, keeping what it desires and rejecting the rest. The part accepted (or rejected) must be a reasonable commercial unit; the issue is not whether some of the composite product could have been provided separately, but whether as provided pursuant to the agreement, it was reasonably a separable commercial unit. A partial acceptance must occur in good faith and in conformance with standards of commercial reasonableness.

Acceptance of a all or part of a performance does not generally waive the party's rights to a remedy for breach..

3. *Conforming Tender Rule.* Subsection (b) adopts the "conforming tender" rule for mass-market transactions that fit the circumstances under which that rule exists under Article 2 of the Uniform Commercial Code (1998 Official Text) - transactions where the only obligation entails providing a single delivery. In more complex transactions, neither Article 2, nor this Act require conforming tender as a precondition to the recipient's obligation to accept.

While sometimes described as a "perfect tender" rule, the "conforming tender" rule does not require tender of a "perfect" copy or "perfect" product. What performance conforms to the agreement depends on what the agreement entails, including the express terms as interpreted in light of usage of trade, course of dealing and concepts of merchantability. In addition, refusal of a tender may yield a right or opportunity to cure. Section 703.

4. *Effective Refusal.* Under subsection (c), refusal of a tender is ineffective if the refusing party does not timely notify the other party of its refusal. This corresponds to waiver rules under common law and this Act. It precludes arguments that silent "refusal" can be effective or coupled with active use of the information.

5. *Refusal and Cancellation.* Many transactions involve contractual commitments that go beyond the obligation to deliver a particular copy. Subsection (d) confirms that an aggrieved party that refuses tender of a copy may cancel the contract only if the breach is a material breach of the entire contract or the agreement so provides. Cancellation of the entire contract requires breach that is material as to the entire agreement, or a contract term that allows cancellation.

2-705. Seller's Stoppage of Delivery in Transit or Otherwise.

(1) The seller may stop delivery of goods in the possession of a carrier or other bailee when he discovers the buyer to be insolvent (Section 2-702) or if the buyer repudiates or fails to make a payment due before delivery or if for any other reason the seller has a right to withhold or reclaim the goods.

(2) As against such buyer the seller may stop delivery until

(a) receipt of the goods by the buyer; or

(b) acknowledgment to the buyer by any bailee of the goods except a carrier that the bailee holds the goods for the buyer; or

(c) such acknowledgment to the buyer by a carrier by reshipment or as a warehouse; or

(d) negotiation to the buyer of any negotiable document of title covering the goods.

(3)(a) To stop delivery the seller must so notify as to enable the bailee by reasonable diligence to prevent delivery of the goods.

(b) After such notification the bailee must hold and deliver the goods according to the directions of the seller but the seller is liable to the bailee for any ensuing charges or damages.

(c) If a negotiable document of title has been issued for goods the bailee is not obliged to obey a notification to stop until surrender of possession or control of the document.

(d) A carrier that has issued a non-negotiable bill of lading is not obliged to obey a notification to stop received from a person other than the consignor.

CONTRACT WITH PREVIOUS VESTED GRANT OF RIGHTS.

Definitional Cross References: Section 102: "Agreement"; "Cancel"; "Contract"; "Copy"; "Delivery"; "Informational Rights"; "Party"; "Seasonably".

Official Comments:

1. *Scope of the Section.* This section deals with an important contractual relationship in information industries that resembles, but differs from "installment" contracts. The similarity lies in that more than one performance by the licensor occurs. The difference is that the performances involve a grant of informational rights followed by delivery of a copy, while installment contracts deal with serial deliveries of copies.

2. *Transactions Covered.* The section distinguishes (1) agreements where a grant to use informational rights vests independent of any copy, and (2) agreements where the purpose is to obtain informational or other rights associated with a copy. It applies to the first context. In that context, the relationship between tender of a defective copy and cancellation of the entire contract or cure is that refusal of the copy does not necessarily permit cancellation of the contract. The contractual grant of rights (already vested) is an independent, performed part of the agreement; any particular copy used to implement that grant is a mere conduit. If the copy does not materially breach the entire contract, the tendering party has a right to cure. That right is cut off only if tender and a failed or delayed cure constitute a material breach of the whole agreement.

3. *Nature of the Transaction.* The section applies only if the contract vests the right or permission to use informational rights without the transferee’s receipt of a copy. Whether this circumstance exists depends on the agreement. When a vested rights transaction occurs, the parties view a copy as a mere conduit to complete an already vested grant. In such cases, a defect in a copy is not necessarily material to the entire contract. In contrast, if the agreement does not create a prior vesting of rights and the transaction is not an installment contract, a material defect in the copy tendered may be material to the entire transaction. This may benefit or disadvantage either party depending on the circumstances. Thus, if the contract is for rights associated with a copy, the licensee that refuses the copy is left solely with an action for damages; refusal in essence cancels the contract. If the

informational rights vest by agreement independent of a copy, the licensee can refuse the copy and still expect and insist on performance and exercise rights under the contract.

Illustration 1. IBM grants licensee (LE) the right to distribute twenty thousand copies of its software in the United States during one year. Several weeks later, IBM delivers a master disk of the software to LE. The master disk contains a manufacturing flaw. The contract is within this section. LE can refuse the copy if the defect was material as to the copy, but cannot cancel the entire contract unless the defect and the delay was material to the entire contract. IBM can cure by timely tendering a conforming copy. LE can recover damages for the delay, if any.

Illustration 2. LE orders a 100 person site license from Red Hat for its operating system software. Red Hat ships a copy of the software, but the copy is warped and defective and arrives several weeks late. This contract is not within this section since there was no vested right to use informational rights independent of the copy to be delivered.

Illustration 3. Prince D's estate grants LE an exclusive license to show still photographs of Prince D on an internet website for one week during June of the first the anniversary of Prince D's death, also giving LE the right to advertise the exhibit. A copy of the photographs is to be delivered one week before the first showing. The copy is delivered several days late and the copy is technically defective and cannot be used. LE refuses the copy. The contract is within this section because the grant of rights is independent of the copy.

2-706. Seller's Resale Including Contract for Resale.

(1) Under the conditions stated in Section 2-703 on seller's remedies, the seller may resell the goods concerned or the undelivered balance thereof. Where the resale is made in good faith and in a commercially reasonable manner the seller may recover the difference between the resale price and the contract price together with any incidental damages allowed under the provisions of this Article (Section 2-710), but less expenses saved in consequence of the buyer's breach.

(2) Except as otherwise provided in subsection (3) or unless otherwise agreed resale may be at public or private sale including sale by way of one or more contracts to sell or of identification to an existing contract of the seller. Sale may be as a unit or in parcels and at any time and place and on any terms but every aspect of the sale including the method, manner, time, place and terms must be commercially reasonable. The resale must be reasonably identified as referring to the broken contract, but it is not necessary that the goods be in existence or that any or all of them have been identified to the contract before the breach.

(3) Where the resale is at private sale the seller must give the buyer reasonable notification of his intention to resell.

(4) Where the resale is at public sale

(a) only identified goods can be sold except where there is a recognized market for a public sale of futures in goods of the kind; and

(b) it must be made at a usual place or market for public sale if one is reasonably available and except in the case of goods which are perishable or threaten to decline in value speedily the seller must give the buyer reasonable notice of the time and place of the resale; and

(c) if the goods are not to be within the view of those attending the sale the notification of sale must state the place where the goods are located and provide for their reasonable inspection by prospective bidders; and

(d) the seller may buy.

(5) A purchaser that buys in good faith at a resale takes the goods free of any rights of the original buyer even though the seller fails to comply with one or more of the requirements of this section.

(6) The seller is not accountable to the buyer for any profit made on any resale. A person in the position of a seller (Section 2-707) or a buyer that has rightfully rejected or justifiably revoked acceptance must account for any excess over the amount of his security interest, as hereinafter defined (subsection (3) of Section 2-711).

DUTIES UPON RIGHTFUL REFUSAL.

Uniform Law Source: Uniform Commercial Code Sections 2-602(2), 2-603, 2-604.

Definitional Cross References. Section 102: "Access material"; "Aggrieved party"; "Agreement"; "Cancel"; "Contract"; "Contractual use term"; "Copy"; "Delivery"; "Good faith"; "Information"; "License"; "Notify"; "Party"; "Seasonably". Section 114: "Reasonable time."

Official Comments:

1. *Scope of the Section.* This section deals with the rights and obligations of a party that rightfully refuses tender of a copy and is in possession or control of it or copies made from it. The section coordinates with Section 802 on cancellation of the contract.

2. *Cancellation and Refusal.* Refusal of a copy may or may not permit or result in a decision to cancel the contract. Upon cancellation, Section 802 applies and controls to the extent of any inconsistency with this section. If the contract is not canceled, this section applies and the parties remain bound by all contractual obligations, except as altered by the breach and the remedies thus available.

The difference lies in the fact that cancellation requires both parties promptly to disengage from the entire contract, returning any material previously received and refraining from any use of the information that would have been allowed under the license. Cancellation ends the license. On the other hand, refusal without cancellation presumes that the contract continues to govern the rights and obligations of the parties, although the refused copy and related material will be returned to the tendering party, or any defect cured.

3. *No Right to Use.* In general, a refusing party has no right to use the refused copies or any copies made from them. Uses inconsistent with this section or the contract are a breach and may, in appropriate cases, be treated as acceptance of the tendered copies. Despite this principle, limited use for purposes of mitigating loss caused by the breach of contract may be permitted. The use must be solely to mitigate and cannot extend to uses that more appropriately should be viewed as acceptance of the copy or to disclosure of confidential information, violation of a contractual use term, or sale or other transfer of the copies, including licensing. This section asks courts to reach the balance that was reached regarding goods in *Can-Key Industries v. Industrial Leasing Corp.*, 593 P.2d 1125 (Or. 1979) and *Harrington v. Holiday Rambler Corp.*, 575 P.2d 578 (Mont. 1978), but with an understanding of the nature of any intellectual property rights that may be involved.

The limited ability to use for purposes of mitigation is also subject to the requirement that the use not be contrary to instructions received from the other party regarding disposition of the information. Instructions that have the effect of preventing use for purposes of mitigation are, in effect, a waiver of the right to insist that mitigation in this form occur. The instructions must, of course, be given in good faith and generally are subject to a standard of commercial reasonableness.

4. *Handling Copies.* Unlike with goods, the refusing party has no right to sell or otherwise dispose of information, documentation or copies under any circumstance. The information may be confidential or subject to overriding proprietary rights held by the other party. There is no commercial necessity to sell that copy to a third party to avoid commercial loss because the copy is not the relevant value in the transaction which focuses on the information.

5. *Confidentiality.* Both parties remain bound by contractual use terms, including confidentiality obligations. Unlike in reference to sales of goods, it is not uncommon that each party have some such information of the other and a mutual, continuing restriction is appropriate to the extent allowed by applicable trade secret or other law. The contractual use terms relate only to the information acquired under and subject to the license. This does not restrict the party's ability to obtain the same information from alternative lawful sources independent of the contract restrictions.

2-707. "Person in the Position of a Seller".

(1) A "**person in the position of a seller**" includes as against a principal an agent that has paid or become responsible for the price of goods on behalf of his principal or anyone that otherwise holds a security interest or other right in goods similar to that of a seller.

(2) A person in the position of a seller has the same remedies as a seller under this Article.

REVOCATION OF ACCEPTANCE.

Uniform Law Source: Uniform Commercial Code Sections 2A-516; 2-608**.**

Definitional Cross References. Section 102: "Contract"; "Copy"; "Information"; "Informational Rights"; "Licensee"; "Notifies"; "Party"; "Receive"; "Seasonable". Section 114: "Reasonable time."

Official Comments:

1. *Scope of Section.* This section corresponds to Uniform Commercial Code §§ 2A-516; 2-608 (1998 Official Text). It deals with revocation of acceptance of a copy and not other performances. Revocation returns the parties to the same position as if the copy had been refused. It is equivalent to rescission. The revoking party is no longer liable for the price of the copy and, in appropriate circumstances, can obtain a refund. "Return" is described in section 102, and is not relevant in this section because it refers to rights on rejection of a contract, not a copy.

2. *Conditions for Revocation.* Revocation is appropriate only for material defects that would have justified refusal had the defect then been known. This is true even in cases involving mass market

licenses. Acceptance of a copy ordinarily establishes closure of the transaction with respect to the copy. That expectation cannot be altered based on minor defects. For this purpose, the general standards of material breach apply. This rule follows law under Article 2 and Article 2A (1998 Official Text). Under subsection (b), effective revocation is conditioned on notification of the other party.

Revocation is inappropriate if based on a defect in the copy or information of which the accepting party was aware when it accepted the copy. This follows Article 2. Acceptance with knowledge of a defect does not eliminate other remedies of the accepting party unless it creates a waiver, but does bar revocation based on the defect unless conditions mentioned in subsection (a) are present. These deal with two different circumstances:

a. Expectation of Cure. Revocation may be permitted if acceptance was on the assumption of cure. See paragraph (a)(1) and (a)(2). Parties may engage in a mutual effort to resolve problems within the contract, rather than by ending it. Paragraph (a)(2) deals with a common issue in software litigation. In cases of continuing efforts to modify the software to fit the contract, both parties know that problems exist. This subsection allows revocation if the effort fails within a reasonable time and other conditions barring revocation do not arise.

b. Latent Defects. Paragraph (a)(3) follows Article 2 of the Uniform Commercial Code (1998 Official Text) and permits revocation if the defect was not discovered before acceptance because of the difficulty of discovery or inducement by the other party that had the effect of delaying discovery.

2-708. Seller's Damages for Non-acceptance or Repudiation.

(1) Subject to subsection (2) and to Section 2-723:

(a) the measure of damages for nonacceptance by the buyer is the difference between the contract price and the market price at the time and place for tender together with any incidental or consequential damages provided in Section 2-710, but less expenses saved in consequence of the buyer's breach; and

(b) the measure of damages for repudiation by the buyer is the difference between the contract price and the market price at the place for tender at the expiration of a commercially reasonable time after the seller learned of the repudiation, but no later than the time stated in paragraph (a), together with any incidental or consequential damages provided in Section 2-710, less expenses saved in consequence of the buyer's breach.

(2) If the measure of damages provided in subsection (1) is inadequate to put the seller in as good a position as performance would have done then the measure of damages is the profit (including reasonable overhead) which the seller would have made from full performance by the buyer, together with any incidental damages provided in this Article (Section 2-710), due allowance for costs reasonably incurred and due credit for payments or proceeds of resale.

RIGHT TO ADEQUATE ASSURANCE OF PERFORMANCE.

Uniform Law Source: Uniform Commercial Code: Section 2-609 (1998 Official Text).

Definitional Cross References. Section 102: "Aggrieved party"; "Contract"; "Contractual use term"; "Delivery"; "Merchant"; "Party"; "Record"; "Received". Section 114: "Reasonable time."

Official Comment: This section corresponds to Article 2 of the Uniform Commercial Code (1998 Official Text) and should be interpreted in that light but with recognition of the different nature of computer information transactions.

2-709. Action for the Price.

(1) When the buyer fails to pay the price as it becomes due the seller may recover, together with any incidental damages under the next section, the price

(a) of goods accepted or of conforming goods lost or damaged within a commercially reasonable time after risk of their loss has passed to the buyer; and

(b) of goods identified to the contract if the seller is unable after reasonable effort to resell them at a reasonable price or the circumstances reasonably indicate that such effort will be unavailing.

(2) Where the seller sues for the price he must hold for the buyer any goods which have been identified to the contract and are still in his control except that if resale becomes possible he may resell them at any time prior to the collection of the judgment. The net proceeds of any such resale must be credited to the buyer and payment of the judgment entitles him to any goods not resold.

(3) After the buyer has wrongfully rejected or revoked acceptance of the goods or has failed to make a payment due or has repudiated (Section 2-610), a seller that is held not entitled to the price under this section shall nevertheless be awarded damages for non-acceptance under the preceding section.

ANTICIPATORY REPUDIATION.

Uniform Law Source: Uniform Commercial Code: Section 2-610.

Definitional Cross References. Section 102: "Aggrieved party"; "Contract"; "Notify"; "Party". Section 114: "Reasonable time."

Official Comment: This section corresponds to Article 2 of the Uniform Commercial Code (1998 Official Text) and should be interpreted in that light but with recognition of the different nature of computer information transactions.

2-710. Seller's Incidental Damages.

(1) Incidental damages to an aggrieved seller include any commercially reasonable charges, expenses or commissions incurred in stopping delivery, in the transportation, care and custody of goods after the buyer's breach, in connection with return or resale of the goods or otherwise resulting from the breach.

(2) Consequential damages resulting from the buyer's breach include any loss resulting from general or particular requirements and needs of which the buyer at the time of contracting had reason to know and which could not reasonably be prevented by resale or otherwise.

(3) In a consumer contract, a seller may not recover consequential damages from a consumer.

RETRACTION OF ANTICIPATORY REPUDIATION.

Uniform Law Source: Uniform Commercial Code: Section 2-611.

Definitional Cross References. Section 102: "Aggrieved party"; "Cancel"; "Contract"; "Party".

Official Comments: This section corresponds to Article 2 of the Uniform Commercial Code (1998 Official Text) and should be interpreted in that light but with recognition of the different nature of computer information transactions.

2-711. Buyer's Remedies in General; Buyer's Security Interest in Rejected Goods.

(1) A breach of contract by the seller includes the seller's wrongful failure to deliver or to perform a contractual obligation, making of a nonconforming tender of delivery or performance, and repudiation.

(2) If the seller is in breach of contract under subsection (1), the buyer, to the extent provided for by this Act or other law, may:

(a) in the case of rightful cancellation, rightful rejection, or justifiable revocation of acceptance, recover so much of the price as has been paid;

(b) deduct damages from any part of the price still due under Section 2-717;

(c) cancel;

(d) cover and have damages under Section 2-712 as to all goods affected whether or not they have been identified to the contract;

(e) recover damages for nondelivery or repudiation under Section 2-713;

(f) recover damages for breach with regard to accepted goods or breach with regard to a remedial promise under Section 2-714;

(g) recover identified goods under Section 2-502;

(h) obtain specific performance or obtain the goods by replevin or similar remedy under Section 2-716;

(i) recover liquidated damages under Section 2-718;

(j) in other cases, recover damages in any manner that is reasonable under the circumstances.

(3) On rightful rejection or justifiable revocation of acceptance a buyer has a security interest in goods in his possession or control for any payments made on their price and any expenses reasonably incurred in their inspection, receipt, transportation, care and custody and may hold such goods and resell them in like manner as an aggrieved seller (Section 2-706).

2-712. "Cover"; Buyer's Procurement of Substitute Goods.

(1) If the seller wrongfully fails to deliver or repudiates or the buyer rightfully rejects or justifiably revokes acceptance, the buyer may "**cover**" by making in good faith and without unreasonable delay any reasonable purchase of or contract to purchase goods in substitution for those due from the seller.

(2) The buyer may recover from the seller as damages the difference between the cost of cover and the contract price together with any incidental or consequential damages as hereinafter defined (Section 2-715), but less expenses saved in consequence of the seller's breach.

(3) Failure of the buyer to effect cover within this section does not bar him from any other remedy.

2-713. Buyer's Damages for Non-delivery or Repudiation.

(1) Subject to Section 2-723, if the seller wrongfully fails to deliver or repudiates or the buyer rightfully rejects or justifiably revokes acceptance:

(a) the measure of damages in the case of wrongful failure to deliver by the seller or rightful rejection or justifiable revocation of acceptance by the buyer is the difference between the market price at the time for tender under the contract and the contract price together with any incidental or consequential damages under Section 2-715, but less expenses saved in consequence of the seller's breach; and

(b) the measure of damages for repudiation by the seller is the difference between the market price at the expiration of a commercially reasonable time after the buyer learned of the repudiation, but no later than the time stated in paragraph (a), and the contract price together with any incidental or consequential damages provided in this Article (Section 2--715), less expenses saved in consequence of the seller's breach.

(2) Market price is to be determined as of the place for tender or, in cases of rejection after arrival or revocation of acceptance, as of the place of arrival.

2-714. Buyer's Damages for Breach in Regard to Accepted Goods.

(1) Where the buyer has accepted goods and given notification (subsection (3) of Section 2-607) he may recover as damages for any non-conformity of tender the loss resulting in the ordinary course of events from the seller's breach as determined in any manner which is reasonable.

(2) The measure of damages for breach of warranty is the difference at the time and place of acceptance between the value of the goods accepted and the value they would have had if they had been as warranted, unless special circumstances show proximate damages of a different amount.

(3) In a proper case any incidental and consequential damages under the next section may also be recovered.

2-715. Buyer's Incidental and Consequential Damages.

(1) Incidental damages resulting from the seller's breach include expenses reasonably incurred in inspection, receipt, transportation and care and custody of goods rightfully rejected, any commercially reasonable charges, expenses or commissions in connection with effecting cover and any other reasonable expense incident to the delay or other breach.

(2) Consequential damages resulting from the seller's breach include

(a) any loss resulting from general or particular requirements and needs of which the seller at the time of contracting had reason to know and which could not reasonably be prevented by cover or otherwise; and

(b) injury to person or property proximately resulting from any breach of warranty.

2-716. Buyer's Right to Specific Performance or Replevin.

(1) Specific performance may be decreed if the goods are unique or in other proper circumstances. In a contract other than a consumer contract, specific performance may be decreed if the parties have agreed to that remedy. However, even if the parties agree to specific performance, specific performance may not be decreed if the breaching party's sole remaining contractual obligation is the payment of money.

(2) The decree for specific performance may include such terms and conditions as to payment of the price, damages, or other relief as the court may deem just.

(3) The buyer has a right of replevin or similar remedy for goods identified to the contract if after reasonable effort the buyer is unable to effect cover for such goods or the circumstances reasonably indicate that such effort will be unavailing or if the goods have been shipped under reservation and satisfaction of the security interest in them has been made or tendered.

(4) The buyer's right under subsection (3) vests upon acquisition of a special property, even if the seller had not then repudiated or failed to deliver.

2-717. Deduction of Damages From the Price.

The buyer on notifying the seller of his intention to do so may deduct all or any part of the damages resulting from any breach of the contract from any part of the price still due under the same contract.

2-718. Liquidation or Limitation of Damages; Deposits.

(1) Damages for breach by either party may be liquidated in the agreement but only at an amount which is reasonable in the light of the anticipated or actual harm caused by the breach, the difficulties of proof of loss, and the inconvenience or nonfeasibility of otherwise obtaining an adequate remedy. Section 2-719 determines the enforceability of a term that limits but does not liquidate damages.

(2) If the seller justifiably withholds delivery of goods or stops performance because of the buyer's breach or insolvency, the buyer is entitled to restitution of any amount by which the sum of the buyer's payments exceeds the amount to which the seller is entitled by virtue of terms liquidating the seller's damages in accordance with subsection (1)

(a) the amount to which the seller is entitled by virtue of terms liquidating the seller's damages in accordance with subsection (1), or

(b) in the absence of such terms, twenty per cent of the value of the total performance for which the buyer is obligated under the contract or $500, whichever is smaller.

(3) The buyer's right to restitution under subsection (2) is subject to offset to the extent that the seller establishes:

(a) a right to recover damages under the provisions of this Article other than subsection (1), and

(b) the amount or value of any benefits received by the buyer directly or indirectly by reason of the contract.

(4) Where a seller has received payment in goods their reasonable value or the proceeds of their resale shall be treated as payments for the purposes of subsection (2); but if the seller has notice of the buyer's breach before reselling goods received in part performance, his resale is subject to the conditions laid down in this Article on resale by an aggrieved seller (Section 2-706).

2-719. Contractual Modification or Limitation of Remedy.

(1) Subject to the provisions of subsections (2) and (3) of this section and of the preceding section on liquidation and limitation of damages,

(a) the agreement may provide for remedies in addition to or in substitution for those provided in this Article and may limit or alter the measure of damages recoverable under this Article, as by limiting the buyer's remedies to return of the goods and repayment of the price or to repair and replacement of non-conforming goods or parts; and

(b) resort to a remedy as provided is optional unless the remedy is expressly agreed to be exclusive, in which case it is the sole remedy.

(2) Where circumstances cause an exclusive or limited remedy to fail of its essential purpose, remedy may be had as provided in this Act.

(3) Consequential damages may be limited or excluded unless the limitation or exclusion is unconscionable. Limitation of consequential damages for injury to the person in the case of consumer goods is prima facie unconscionable but limitation of damages where the loss is commercial is not.

2-720. Effect of "Cancellation" or "Rescission" on Claims for Antecedent Breach.

Unless the contrary intention clearly appears, expressions of "cancellation" or "rescission" of the contract or the like shall not be construed as a renunciation or discharge of any claim in damages for an antecedent breach.

2-721. Remedies for Fraud.

Remedies for material misrepresentation or fraud include all remedies available under this Article for non-fraudulent breach. Neither rescission or a claim for rescission of the contract for sale nor rejection or return of the goods shall bar or be deemed inconsistent with a claim for damages or other remedy.

2-722. Who Can Sue Third Parties for Injury to Goods.

Where a third party so deals with goods which have been identified to a contract for sale as to cause actionable injury to a party to that contract

(a) a right of action against the third party is in either party to the contract for sale that has title to or a security interest or a special property or an insurable interest in the goods; and if the goods have

been destroyed or converted a right of action is also in the party that either bore the risk of loss under the contract for sale or has since the injury assumed that risk as against the other;

(b) if at the time of the injury the party plaintiff did not bear the risk of loss as against the other party to the contract for sale and there is no arrangement between them for disposition of the recovery, his suit or settlement is, subject to his own interest, as a fiduciary for the other party to the contract;

(c) either party may with the consent of the other sue for the benefit of which it may concern.

2-723. Proof of Market Price: Time and Place.

(1) If evidence of a price prevailing at the times or places described in this Article is not readily available the price prevailing within any reasonable time before or after the time described or at any other place which in commercial judgment or under usage of trade would serve as a reasonable substitute for the one described may be used, making any proper allowance for the cost of transporting the goods to or from such other place.

(2) Evidence of a relevant price prevailing at a time or place other than the one described in this Article offered by one party is not admissible unless and until he has given the other party such notice as the court finds sufficient to prevent unfair surprise.

2-724. Admissibility of Market Quotations.

Whenever the prevailing price or value of any goods regularly bought and sold in any established commodity market is in issue, reports in official publications or trade journals or in newspapers or periodicals of general circulation published as the reports of such market shall be admissible in evidence. The circumstances of the preparation of such a report may be shown to affect its weight but not its admissibility.

2-725. Statute of Limitations in Contracts for Sale.

(1) Except as otherwise provided in this section, an action for breach of any contract for sale must be commenced within the later of four years after the right of action has accrued under subsection (2) or (3) or one year after the breach was or should have been discovered, but no longer than five years after the right of action accrued. By the original agreement the parties may reduce the period of limitation to not less than one year but may not extend it. However, in a consumer contract, the period of limitation may not be reduced.

(2) Except as otherwise provided in subsection (3), the following rules apply:

(a) Except as otherwise provided in this subsection, a right of action for breach of a contract accrues when the breach occurs, even if the aggrieved party did not have knowledge of the breach.

(b) For breach of a contract by repudiation, a right of action accrues at the earlier of when the aggrieved party elects to treat the repudiation as a breach or when a commercially reasonable time for awaiting performance has expired.

(c) For breach of a remedial promise, a right of action accrues when the remedial promise is not performed when performance is due.

(d) In an action by a buyer against a person that is answerable over to the buyer for a claim asserted against the buyer, the buyer's right of action against the person answerable over accrues at the time the claim was originally asserted against the buyer.

(3) If a breach of a warranty arising under Section 2-312, 2-313(2), 2-314, or 2-315, or a breach of an obligation, other than a remedial promise, arising under Section 2-313A or 2-313B, is claimed, the following rules apply:

(a) Except as otherwise provided in paragraph (c), a right of action for breach of a warranty arising under Section 2-313(2), 2-314, or 2-315 accrues when the seller has tendered delivery to the immediate buyer, as defined in Section 2-313, and has completed performance of any agreed installation or assembly of the goods.

(b) Except as otherwise provided in paragraph (c), a right of action for breach of an obligation, other than a remedial promise, arising under Section 2-313A or 2-313B accrues when the remote purchaser, as defined in Section 2-313A or 2-313B, receives the goods.

(c) If a warranty arising under Section 2-313(2) or an obligation, other than a remedial promise, arising under Section 2-313A or 2-313B explicitly extends to future performance of the goods and discovery of the breach must await the time for performance, the right of action accrues when the immediate buyer as defined in Section 2-313 or the remote purchaser as defined in Section 2-313A or 2-313B discovers or should have discovered the breach.

(d) A right of action for breach of warranty arising under Section 2-312 accrues when the aggrieved party discovers or should have discovered the breach. However, an action for breach of the warranty of noninfringement may not be commenced more than six years after tender of delivery of the goods to the aggrieved party.

(4) Where an action commenced within the time limited by subsection (1) is so terminated as to leave available a remedy by another action for the same breach such other action may be commenced after the expiration of the time limited and within six months after the termination of the first action unless the termination resulted from voluntary discontinuance or from dismissal for failure or neglect to prosecute.

(5) This section does not alter the law on tolling of the statute of limitations nor does it apply to causes of action which have accrued before this Act becomes effective.

2-801. REMEDIES IN GENERAL.

Uniform Law Source: Uniform Commercial Code Section 2A-523.

Definitional Cross References. Section 102: "Aggrieved party"; "Agreement"; "Contract"; "Contractual use term"; "Information"; "Party".

Official Comments:

1. *General Scope.* This section states general rules relevant to contract law remedies. Like all other rules in this Act, unless otherwise expressly indicated, the effect of the rule can be varied by agreement.

2. *Cumulative Remedies.* Contract remedies aim to put an aggrieved party in the position that would resulted if performance had occurred as agreed. To that end, the remedies in this Act are cumulative to the extent consistent with the general goal; this Act rejects any concept of election of remedies. However, the parties by agreement may alter a remedy or make it unavailable, which agreement controls unless expressly invalidated by a provision of this Act.

3. *Aggrieved Party Choice.* An aggrieved party chooses the remedy, subject to substantive limitations applicable under this Act or the agreement. Beyond these express limits and its exercise of equity and the like, the court does not control the choice.

4. *Remedies Retained.* This Act is supplemented by various general sources of law, including equitable remedies. A remedy for breach does not displace a right of action under intellectual property law. Damage awards are limited, of course, by the principle that prohibits double recovery for the same wrong, but often the two forms of recovery refer to different damages and are not a double recovery.

2-802. CANCELLATION.

Uniform Law Source: Uniform Commercial Code: Sections 2A-505; 2-106(3)(4), 2-720.

Definitional Cross References: Section 102: "Aggrieved party"; "Agreement"; "Cancellation"; "Copy"; "Contract"; "Information"; "Informational Rights"; "License"; "Notify"; "Party"; "Term". Section 114: "Reasonable time". Section 701: "Material breach".

Official Comments:

1. *Scope of the Section.* This section describes when cancellation is permitted and what is the effect of cancellation.

2. *Cancellation.* "Cancellation" means that one party ends the contract for breach. Section 102. As with termination, it discharges executory obligations, but does not alter rights that were earned by prior performance or established by breach. Cancellation is a remedy for breach.

3. *When Permitted.* Subsection (a) states two cases when cancellation is permitted. First, it recognizes the general principle allowing cancellation if the agreement provides that cancellation is appropriate for the breach. Second, it allows cancellation in the event of a material breach. Unless there is contrary agreement, cancellation cannot occur in the event of a non-material breach of contract.

What is a material breach depends on the agreement or the nature or effect of the breach. Section 701. A material breach does not require that the aggrieved party cancel. It may continue to perform, demand reciprocal performance, and collect damages. However, if it does not cancel and the breaching party cures the breach, cure precludes cancellation based on the cured breach.

4. *Notification.* Subsection (b) requires giving notification to the breaching party to make the cancellation effective. Section 102 (notify or give notice). This is a new requirement intended to avoid unfair surprise. It must be interpreted in light of the circumstances. Cancellation cannot occur unless

there was a breach and either the contract gives a right to cancel for the particular breach or the breach was material. The equities favor the injured party, not the party in breach. No specific formalities are required. It is sufficient that the aggrieved party by its actions or words communicate its belief that the contract has ended because of the breach. Thus, for example, in a contract calling for a single delivery of a copy, the decision to refuse the copy, return it, and demand a refund is sufficient notification that the contract is canceled. Similarly, commencing an arbitration proceeding based on cancellation is obvious notice of cancellation. The aggrieved party is not required to use formal legal terminology or procedures.

Giving notice to the other party does not require proof that the notice is received. See Section 102. The aggrieved party is not required at its risk to select a fail safe notification procedure.

Notification is not required for an access contract. This corresponds to termination of such contracts and general common law.

5. *Effect on Use Rights.* A license gives permission to the licensee to use, access or take other designated actions without an infringement claim by the licensor. If a license is canceled, that "defense" dissolves. A licensee who continues to act in a manner inconsistent with intellectual property rights of the licensor exposes itself to an infringement claim. See *Schoenberg v. Shapolsky Publishers, Inc.*, 971 F.2d 926 (2d Cir. 1992). In some cases, information obtained under a contract is not subject to intellectual property rights. Then, cancellation does not create a risk of infringement.

6. *Obligations Regarding Copies.* In general, cancellation ends the contractual permission to use information and, in a license, contractual permission to retain copies of licensed information. Subsection (c) sets out some of the consequences of that result. However, subsection (c)(4) allows limited use by the licensee in a case where the licensee cancels because of the licensor's breach. This right is narrow and solely for the purpose of allowing mitigation. See Comments to Section 706. It does not create an implied license, but merely implements a limited contractual remedy premised on the basic principle that there is a duty to act reasonably to avoid loss in the event of breach. Any use outside of that principle is wrongful.

7. *"No cancellation" clause.* Especially where information is licensed for inclusion in another product, a common remedy limitation provides that the licensor cannot cancel for breach, but is limited to other remedies. The clause is effective as a remedy limitation, but does not alter other remedies allowed by the contract or this Act. Assume a software license requiring five years of fixed payments and including a "no cancellation" clause except for violations of use restrictions.

If the licensor breaches, the licensee cannot cancel and must continue to make payments but its remedies of recoupment, off-set, or damages remain intact. The licensee is not required to pay for information that it did not receive. If the licensee breaches, the licensor cannot cancel and must allow the licensee to use the software for the 5 year term, but its remedies of recoupment, off-set or damages also remain intact. The licensor is not required to provide rights under terms different than the license terms. In both cases, the remedies retained are subject to any modification made in the contract.

2-803. CONTRACTUAL MODIFICATION OF REMEDY.

Uniform Law Source: Uniform Commercial Code: Section 2-719.

Definitional Cross References. Section 102: "Aggrieved party": "Agreement"; "Cancel"; "Computer program"; "Consequential damages"; "Consumer"; "Consumer contract"; "Contract"; "Incidental damages"; "Party"; "Term".

Official Comments:

1. *Scope of the Section.* This section deals with enforceability of agreed limitations on remedies for breach.

2. *Agreement Controls.* Parties may agree to fit their remedies to their particular deal. This is a fundamental facet of contract practice that influences and defines the product offered and the cost of a transaction. A party that agrees to accept all liability for breach may change the product it is willing to offer or charge more for a transaction than will a party that can contractually allocate liability or limit it to a particular amount or other remedy.

Similarly, a party may not be willing to acquire a product unless it obtains particular remedies and recourse in particular or unlimited amounts, regardless of cost. How parties will order these needs and choices depends on the context, but no principle of law or policy suggests that the ability to control this attribute of a transaction should be generally precluded. This Act does preclude alteration of remedies for a right of return as defined in Section 102 and as used in Sections ____[xxx] and ____ with respect to rejected records; "return" as used in this section does not refer to a rejected record and thus is not included in the listing of defined terms.

3. *Exclusive Remedies.* An agreed remedy may be a modification or replacement for otherwise available remedies, or an additional right created by contract. To be an exclusive remedy, the terms of the agreement must expressly so provide. Subsection (a)(2) follows Article 2 of the Uniform Commercial Code (1998 Official Text) in this respect.

4. *Listed Illustrations.* Subsection (a) lists several remedies common in commercial practice. The illustrations, which are not an exclusive list,include:

a. Replacement, Repair and Refund. Agreed limited remedies that refer to replacement, repair, or refund are common. In end-user transactions for single copies of information, the reference to refund ordinarily refers to refund of the single license fee. The three different terms however, typically indicate entirely different remedies: replacement refers to supplying another copy of the same product, repair obligates the party to revise the product to eliminate defects that cause nonconformance with the contract, and refund obligates it to return money already paid. The purpose of a "replacement" or a "repair" obligation is to limit remedies, but also to provide the licensee with an information product that fulfills contract obligations. The purpose of the "refund" remedy is to reimburse moneys paid by the licensee for the product and to limit damages.

A limited remedy may provide any adequate agreed remedy. While many transactions involve contract fees based on a single payment, others entail royalties or other fees to be paid in the future. In such cases, nothing in this section restricts the ability of parties to agree to return of a fixed maximum amount or portion of the expected fee. Furthermore, refund contemplates return of payments, not payment to cover all value that might have been received. Another example of a situation where less than all payments may be covered under a refund remedy is an on-going or other services-like contract where a breach does not occur untilthe third or fourth year of a five year relationship.

b. No Cancellation. Subsection (a) lists a remedy (barring cancellation) relevant in for a licensee when it commits resources to develop and exploit information licensed to it. The ability to bar cancellation by agreement is important in this commercial environment where the licensee may devote great resources to development of a further product based on the originally licensed information. See comments to Section 802. The right has no adverse effect in consumer contracts since, even if a consumer agrees to not cancel, other remedies (refusal, recoupment, damages) allow it fully to protect its interest.

5. *Failure of Exclusive Remedy.* Subsection (b) and (c) follow Article 2 of the Uniform Commercial Code (1998 Official Text) but clarify an issue extensively litigated under Article 2.

a. Failure of Remedy. Under subsection (b), if performance of a limited or exclusive remedy causes it to fail of its intended purpose, the remedy no longer limits the remedies of the aggrieved party who may resort to any remedies available under this Act. This same rule is present in Article 2. To administer the rule, courts must ask what was the essential purpose of the agreed remedy. A difference exists for remedies limited to replacement or repair of a defective copy, and remedies that also include a refund right. In the latter case, the purpose of the remedy is to either provide a functioning product or return the other party's money. Performance of the refund remedy meets this purpose even if the licensee did not receive a functioning product. Whether performance of the refund remedy meets its essential purpose depends on whether the agreed amount agreed was actually provided. This contrasts to a situation in which the remedy requires replacement or repair, but does not allow a refund. An example would be a repair or replacement remedy for a product flaw -- non-performance of the remedy leaves the licensee without what it expected under the contract – a functioning product. In situations where the defect cannot be corrected because, for example, it lies in the design of the product, the "repair" remedy fails.

b. Related to Consequential Damage Limits. Subsection (c) deals with the effect that failure of a limited remedy has on agreed limitations on or exclusion of consequential damages. The issue is whether one term (exclusion of consequential damages) depends on, or is independent of, another term (limited remedy). This section establishes a default rule that the two terms are dependent unless the agreement expressly indicates otherwise. This resolves a conflict under Article 2 of the Uniform Commercial Code.

This rule is favorable to licensees: a consequential damage limit fails if the limited remedy fails, unless the agreement makes the consequential damages limit expressly independent of the other limited remedy. This treats the two terms as a package unless the agreement indicates otherwise. If the agreement expressly states that the terms are independent, however, there is no reason in principle to preclude enforcement of that agreement.

A consequential damages limitation covers all obligations and remedies under the contract. Some commentators characterize the obligation to replace or repair in a limited remedy as a separate contractual obligation, breach of which creates a damages claim. Whether that is correct or whether

the remedy clauses are better treated as a single overall transaction, is ultimately not relevant, except with respect to asking what default principles should apply to the agreement, which should depend on the actual expectations of the parties. This Act treats remedy clauses as part of an overall transaction and assumes that a consequential damages limitation applies to all loss. A failure of the remedy results in failure of that limitation unless the agreement expressly provides that the consequential damages limitation is independent of the remedy limitation. In that case, the consequential damage limit continues to apply to any and all consequential damages incurred in the overall transaction.

6. *Minimum Adequate Remedy.* An agreed remedy provision does not fail because the court believes that it does not afford a "minimum adequate remedy." Doctrines of unconscionability, fundamental public policy and for determining whether mutuality of obligation exists for a binding contract set a floor on what agreed terms are binding with respect to remedies.

The essence of any contract is that parties accept the legal consequences of their deal and that there be at least a fair quantum of remedy in the event of breach. Contracts that do not do so may fail for lack of consideration or mutuality. This does not mean that a court can, after the fact, rewrite the contract for remedies rules. If a remedy is provided and made exclusive, the fact that it does not fully compensate the aggrieved party is not a reason to allow that party to avoid the consequences of its agreement. That result flows from the agreed allocation of risks. For example, a contract that limits recovery for software defects used in a satellite system to the price of the software (e.g., $100,000) is not rendered unenforceable because the licensee used the software and a defect caused loss of a $1 million satellite. The decision to set a limit affects pricing and risk and cannot be set aside because the risk eventually fell on one party. On the other hand, a contract that states "licensee will have no responsibility for any harm to licensor caused by licensee's breach of any aspect of the agreement" may raise a question of whether the agreement had sufficient mutuality to establish a contract.

7. *Consequential Damage Limits.* Disclaimer or limitation of consequential damages are generally enforceable. In consumer transactions involving defective computer programs that cause personal injury, however, this section follows Article 2 of the Uniform Commercial Code (1998, Approved Drafrt) and makes disclaimer of personal injury damages prima facie unconscionable. This does not create liability where it would not exist under other law.

In practice, most cases do not rely on contract law for liability for personal injury even in contracts involving goods. As to information, most cases reject personal injury claims against information providers even under tort law. This reflects that in reference to information products, courts must balance public interests in encouraging distribution of information against interests in creating new sources of recovery. This Act does not preclude courts using general theories of tort law to do so, if contrary to the prior development of such law, they conclude that such risk allocation is appropriate.

2-804. LIQUIDATION OF DAMAGES.

Uniform Law Source: Uniform Commercial Code Section 2-718 (1998 Official Text). Revised.

Definitional Cross References. Section 102: "Aggrieved party"; "Agreement"; "Contract"; "Copy"; ""Delivery"; "Party"; "Receive";"Term".

Official Comments:

1. *Scope of the Section.* This section deals with the enforceability of liquidated damages clauses. The basic approach is that agreed terms are enforceable unless unreasonable.

2. *General Standard.* A liquidated damages term sets both a minimum and maximum recovery, while for example, a damage limitation caps recovery to a stated amount, but does not permit that recovery if facts do not support damages in the amount of the stated maximum.

An agreed term liquidating damages in the event of breach is, in concept, no different than any other term. The presumption is that courts should enforce agreed terms . Under subsection (a), liquidated damages terms are enforced if the amount is reasonable in light of any of 3 factors. This section follows common law and expands the conditions that sustain enforceability of liquidation clauses. The clause is sustainable if reasonable in light of 1) before-the–fact estimates of likely damages; or 2) after-the-fact actual damages or 3) the difficulty of proof. Basically, the term is enforceable unless there is no reasonable basis on which to sustain it.

A liquidated damage amount chosen by the parties based on their assessment of risk and cost at the time of the contract should be enforced. A court should not revisit the deal after the fact and disallow a contractual choice because the choice later appeared to disadvantage one party. Among other results, this approach indicates that, if the parties actually negotiated the clause, that clause is per se reasonable. Actual negotiation, however, is not essential to enforceability.

3. *Remedies On Unenforceability.* If a liquidated damages term is not enforceable, the aggrieved party may pursue the remedies it would have had under this Act in the absence of the term. Those remedies are limited by other terms of the agreement. For example, if a liquidated damage clause fails in a contract that excludes consequential damages, the aggrieved party is still bound by that exclusion.

4. *Other Terms.* If a term is not a liquidated damage clause but is a limitation on damages, then the appropriate default rule is Section 803, not Section 805. Thus, if a term provides: "In no event shall either party be liable for damages exceeding $1 million dollars," it is a limitation on damages, not a liquidated damages term. It caps recovery but does not permit recovery if facts do not support damages in the amount of the stated maximum.

2-805. STATUTE OF LIMITATIONS.

Uniform Law Source: Uniform Commercial Code: Sections 2A-506; 2-725 (1998 Official Text). Revised.

Definitional Cross References. Section 102: "Aggrieved party"; "Agreement"; "Consumer"; "Contract"; "Copy"; "Deliver"; "Information"; "Party"; "Termination".

Official Comments:

1. *Scope and Purpose.* This section introduces a uniform statute of limitations for computer information transactions, reconciling conflicting state law. **2.** *Limitations Period.* Subsection (a) blends the traditional rule that a cause of action accrues when the breach occurs with a discovery rule and a rule of repose. This section thus follows Article 2 of the Uniform Commercial Code (1998 Official Text) that bars a cause of action four years after the breach occurs. However, it also adopts a "discovery rule" that expands the time for bringing a cause of action beyond that applicable for sales of goods. The discovery rule extends the time for bringing the lawsuit to up to five years from the time of breach.

3. *Effect of Agreement.* Subsection (b) limits the enforceability of agreements that modify the limitations period. The statute of limitations reflects public policy about how long of a period may be permitted before law concludes that no action may be brought. Subsection (b) disallows agreements that permit a period of limitations longer than that stated in the Act, following the policy in Article 2 of the U.C.C. This does not prevent "tolling agreements" entered into during contract disputes. It only precludes extensions in the *original* agreement.

Subsection (b) does not preclude contracts that "limit" a warranty to a stated period of less than one year (e.g., ninety days). Such agreements define a term during which discovery of a breach and its effect must occur. Unless the agreement so states, this does not limit the time (the statute of limitations) in which a lawsuit may be brought. Thus, a ninety day warranty means that there is no breach unless the defect appears is discovered within ninety days after delivery, but if such occurs, the agreement does not restrict how long the aggrieved party may wait before bringing the lawsuit. That is determined by this section. The period to bring the lawsuit is 4 or 5 years, depending upon when breach occurred or should have been discovered unless, in a commercial contract, that period is reduced by agreement to not less than one year.

4. *Accrual of Cause of Action: Time of Performance.* The four year term refers to four years from when the right of action accrues. This section applies two different rules for determining when the cause of action accrues. The primary rule is in subsection (c). The cause of action accrues when the breach occurs or should have been discovered. In reference to an alleged breach of warranty generally, this occurs on delivery of the information or service, even if the performance defect does not become apparent until much later. Warranties are breached or not on delivery of the warranted subject matter.

In some cases, a warranty "extends to future conduct." For example, if a warranty is that there are no defects that affect performance during the first ninety days after delivery, subsection (c) requires a court to apply this language according to its terms. Breach of this warranty occurs if a defect appears within that ninety day period. Subsection (c) rejects interpretations of the Article 2 rule to mean that such a warranty changes the limitations rule to a pure "discovery" rule, i.e., the cause of action does not accrue until the defect is or should have been discovered. That approach subverts the intent of the "future" warranty. If the warranty for future performance is time limited (e.g., one year warranty), the time of breach cannot be later than the expiration of that stated time.

5. *Discovery Rule.* Subsection (d) describes cases in which the time of occurrence rule is replaced entirely by a time of discovery rule. Each concerns circumstances in which it would be inappropriate to define breach as occurring when performance is delivered because the breach is never manifested until later and because the assurances involved in the contract obligation go to events beyond the time of delivery.

2-806. REMEDIES FOR FRAUD.

Uniform Law Source: Uniform Commercial Code: Section 2-721 (1998 Official Text).**Definitional Cross References.** Section 102: "Contract"; "Information".

Official Comment: Follows Article 2 of the Uniform Commercial Code (1998 Official Text).

2-807. MEASUREMENT OF DAMAGES IN GENERAL.

Definitional References. Section 102: "Aggrieved party"; "Agreement"; "Consequential damages"; "Contract"; "Direct damages"; "Information"; "Informational content"; "Party"; "Present value"; "Published informational content".

Official Comments:

1. *Scope of the Section.* This section brings together general rules on computation of damages. Specific approaches for licensor damages are in Section 808 and for licensee damages in Section 809. Both sections are subject to the general principles stated here. **2.** *Mitigation.* Subsection (a) requires mitigation of damages and places the burden of proving a failure to mitigate on the party asserting the protection of the rule. "Burden of establishing" means that the party with the burden of persuading the trier of fact that the existence of the fact is more probable than its non-existence. Uniform Commercial Code § 1-201(8) (1998 Official Draft).

The idea that an injured party must mitigate its contract damages permeates contract law. Contract remedies are not punitive but compensatory. The injured party cannot act in a way that enhances loss and expect to have that loss compensated in damages recoverable from the other party. This does not create an obligation of an aggrieved party to cover. The damages formulae in Section 808 and 809 contain various means of adjusting damages by statutory measures that in effect are a surrogate for mitigation (e.g., the statutory formulae based on market value of the performance). If the formula is used to compute damages, whether there was a actual mitigation is not relevant. The market value reference in subsection (d) limits direct damages in a manner consistent with principles of mitigation. However, this Act also allows recovery of consequential as compared to direct damages and mitigation issues are relevant to such claims.

The reference in subsection (a) to otherwise provided in the agreement includes contractual liquidation of damages. An enforceable liquidated damages term creates an agreed measure of damages. A court may not reduce or alter that contractual measure based on its determination about whether actual damages were adequately mitigated or not.

3. *Published Informational Content.* Subsection (b) excludes consequential damages for issues about the content of "published informational content." Whether characterized as a First Amendment analysis or treated as a question of simple social policy, our culture has a substantial interest in promoting the dissemination of information. This Act supports and encourages distribution of informational content to the public.

As indicated in the definition of published informational content, the context is one in which the content provider does not deal directly with the data recipient in a special reliance setting. Information of this type is typically low cost and high volume. Dissemination of such information would be seriously impeded by high liability risk. With few exceptions, modern law recognizes the liability limitations even under tort law. The *Restatement of Torts*, for example, limits exposure for negligent error in data to intended recipients and to "pecuniary loss" which corresponds to direct damages.

The subsection does not exclude all consequential damage claims relating to published informational content. For example, if a party agrees to provide content for distribution over the Internet, but fails to deliver in a timely fashion, the resulting damages claim does not pertain to the content itself, but to the failed performance. Whether consequential loss is recoverable is determined under the general standards of this Act, the agreement of the parties and common law.

Illustration 1: D distributes stock market information through newspapers and on-line for $5 per hour or $1 per copy. C reviews the on-line information and trades 1 million shares of Acme at a price that causes a $10 million loss because the data were incorrect. If C were in a relationship of reliance with D, consequential loss is recoverable. But this is published informational content, and C cannot recover alleged consequential loss.

Illustration 2: Internet-Games.com allows players to play a grisly 3-D game. One player who pays $5 is shocked by the violence and spends a sleepless week. That customer should have no recovery at all, but if it can show a breach, the individual could not recover consequential loss since this is published informational content.

Each illustration assumes that the contract for the published informational content did not expressly provide for consequential damages.

4. *Speculative Damages.* This Act does not require proof with absolute certainty or mathematical precision. Consistent with the principle of Article 1 of the Uniform Commercial Code that there be a liberal administration of the remedies of that Code, the remedies in this Act must be administered in a reasonable manner. However, this does not permit recovery of losses that are speculative or highly uncertain and therefore unproven. See *Restatement (Second) of Contracts* 352 ("Damages are not recoverable for loss beyond the amount that the evidence permits to be established with reasonable certainty."). No change in law on this issue is intended; courts should continue to apply ordinary standards of fairness and evaluation of proof. For an illustration in an information transaction, see *Freund v. Washington Square Press, Inc.*, 34 N.Y.2d 379, 357 N.Y.S.2d 857, 314 N.E.2d 419 (1974).

5. *Confidential Information.* Subsection (c) confirms that one way of measuring loss in the case of confidentiality breaches is in terms of the value obtained by the breaching party. In essence, where a confidential relationship exists, the party to whom the confidentiality obligation is owed has an expectation of the information not being misused and that expectation is entitled to protection. Lost value does not easily fit into the idea of damages resulting from breach. Yet, compensation for such loss is important. Where the breach of confidence gives benefits to a third party that are not realized directly or indirectly by the party to the contract, recovery, if any, occurs under other law. The principle stated here, of course, is subject to the general ability of a court to exclude recovery that would put a party into a substantially better position than would have been true in the absence of breach and the basic principle that double recovery is not allowed. Section 801.

6. *Market Value.* If market value is part of a damages computation, subsection (d) requires that market value be determined at the time and place for performance. Where performance is delivery of a copy, the place is as indicated in the agreement or this Act. In other cases, such as an Internet transaction that provides access to an information system, the nature of the subject matter makes geographic touchstones difficult to determine or inappropriate. In such cases, courts may refer to rules on choice of law in this Act, which provide a stable reference point relevant to and protective of both parties.

In determining market value, due weight must be given to any substitute transaction actually entered into by a party, taking into account the extent to which the transaction involved terms, performance, information, and informational rights similar in terms, quality, and character to the agreed performance. See Comments to Section 808(a).

7. *Present Value.* Subsection (e) provides that damages as to future events are awarded based on present value as of the date of judgment. The definition of "present value" corresponds to Uniform Commercial Code §§ 2A-103; 1-201(37)(z) (1998 Official Text), but modifies the rules to cover present valuation of performances other than payments. This term provides for discounting the value of future payments or losses as measured at a particular point in time. This requires that, as to damages awarded for eventualities that are in the future, courts do so based on a present value standard. As to losses and expenses that have already occurred, the present value measurement does not apply. No change in law on pre-judgment interest is intended.

2-808. LICENSOR'S DAMAGES.

Uniform Law Source: Uniform Commercial Code: Sections 2A-528; 2-708 (1998 Official Text). Revised.

Definitional Cross References. Section 102: "Cancel"; "Consequential damages"; "Contract"; "Contract fee"; "Contractual use term"; "Direct damages"; "Good faith"; "Incidental damages"; "Information"; "Informational rights"; "Licensee"; "Licensor"; "Present value"; "Receive".

Official Comments:

1. *Scope of the Section.* This section deals with licensor damages. It allows the licensor to choose among alternatives to fit the circumstances. The choice is subject to prohibition on double recovery. Section 807 provides that damages related to events in the future at the time of the award are based on their present value. It also provides for when and where "market value" is determined.

2. *General Approach.* The licensor may elect damages under any measure described in subsection (b). The basic approach assumes that the aggrieved party chooses the method of computation, subject to judicial review of whether the choice enables double recovery. No order of preference is required.

Subsection (b)(1) measures "direct damages" by the difference in value between performance promised and received. Direct damages also include reimbursement for value already given to the other party and not paid for when appropriate. These damages are capped by the contract fee for the breached performance and the market value of other consideration to be received. This does not include the loss of expected benefits from use of the expected performance in other contexts. If recoverable, those are consequential, not direct damages.

All damages recoverable under this section are subject to general principles of this Act. Section 807 disallows recovery of consequential losses in some cases, including damage claims that are speculative or claims for consequential damages based on the content of published informational content. Similarly, under Section 807, recovery may be limited by the requirement that the aggrieved party act in a reasonable manner to avoid or reduce loss.

3. *Intangible Subject Matter: Substitute Transactions.* Licensor remedies differ from remedies for sellers under Article 2 of the Uniform Commercial Code. Article 2 focuses damage calculation on an assumption that the seller's loss lies in the disposition of the particular item. For computer information transactions, the particular copy is not the focus. In this Act. the basic principle is whether breach enables a substitute transaction that could not otherwise have occurred and the returns from which are properly considered in determining direct damages.

The term "substitute transaction" is central to the damages structure. A transaction is not a substitute simply because the transferor used a diskette or other media that might have been used to deliver the same information to the licensee in breach. The focus is on the information, not the tangible media, and on contractual use terms associated with the transaction. To be a substitute transaction, the transaction must involve the same information under the same contractual use terms applicable to the transaction in breach.

To be a substitute transaction it must be made possible by the breach. This rule has two effects. First, it requires that a substitute transaction must be possible. If there is no market and no alternative licensee for the same information product under the same terms, no substitute is possible. That will often occur when the contract is to develop software for a particular application of the licensee. Second, if a similar transaction is possible, the licensor's ability to engage in it must be due to the breach and not simply because the other transaction would have been possible in any event. For example, in breach of a non-exclusive access contract, there would ordinarily not be a substitute transaction because the licensor has effectively unlimited capability to make access available to others. While another access contract may be made, it was not made possible by breach – the new license would have occurred with or without the breach. In most non-exclusive licenses, breach does not enable a new transaction. Information assets are available in relatively infinite supply. On the other hand, breach of an exclusive license to distribute a work in a geographic area may, if it leads to cancellation of the license, enable the licensor to make a substitute license for that area that could not otherwise have been made because of the exclusive nature of the breached license.

4. *Computation Approaches.* The damage formulae describe direct damages and are capped in total recovery by the contract fee and the market value of other consideration to be received by the licensor. They yield the following results:

a. Accrued Fees and Consideration. Paragraph (b)(1)(A) recognizes that the aggrieved licensor is entitled to recover any accrued and unpaid fees and the value of other consideration owed for information or services actually delivered. These are direct damages. Recoveries beyond that, if appropriate, are in the nature of consequential or incidental damages.

b. Measuring other Direct Damages. This section outlines several approaches to direct damages in addition to unpaid fees and consideration.

(i) Recovery Measured by Contract Fee: Substitute Transaction Enabled. Paragraph (b)(1)(B) describes recovery measured by unaccrued contract fees and other consideration less the value of an actual or hypothetical substitute transaction made possible by the breach. Section 807 requires computation at present value for losses associated with events occurring after judgment. The future contract fees or other consideration must be proven with sufficient certainty to allow recovery. Speculative damages are not recoverable. *Restatement (Second) of Contracts* § 352. See Section 807.

The recovery is reduced by due allowance for the proceeds of a substitute transaction made possible by the breach measured either by an actual substitute transaction or the market value of a commercially reasonable hypothetical transaction. The substitute transaction must have been made possible by the breach. If the breach makes possible a substitute transaction, but no such transaction actually occurs, the recovery if sought under this paragraph, is reduced by the market value (if any) of the hypothetical substitute made possible by the breach. As with actual transactions, market value of a hypothetical substitute must utilize a market for the same use restrictions for the same information.

(ii) *Recovery Measured by Lost Profits.* Paragraph (b)(1)(C) provides as an alternative that losses may be measured by lost profits caused by a failure to accept performance or by repudiation of the contract. The computation of what profits would have occurred in the event of performance necessarily would take into account the expenses of performance by the licensor. Courts should refer to common law cases on licenses. Unlike in Article 2 of the Uniform Commercial Code (1998

Official Text), however, this Act does not require proof that the alternative standards are inadequate to compensate the licensor. The injured party chooses the method of computation.

As with contract fees, lost profits must be proven with reasonable certainty and may not be merely speculative. *Restatement (Second) of Contracts* § 352. Similarly, recovery is subject to the general duty to mitigate. See Section 807 and *Krafsur v. UOP, (In re El Paso Refinery)*, 196 BR 58 (Bankr. WD Tex. 1996).

(iii) Measurement in any Reasonable Manner. Subsection (b)(1)(D) authorizes computation of direct damages in any manner that is reasonable, and thus recognizes that the diversity of contexts present in this field make the specific formulae useful, but potentially inapplicable in some cases. ***c****. Consequential and Incidental Damages.* The licensor is also entitled, in an appropriate case, to recover consequential and incidental damages. The section distinguishes between contract fees and royalties on the one hand (as direct damages) and consequential damages on the other. See discussion in comments to Section 102 on consequential damages. The damage recovery is also subject to the general provisions of Section 801 and 807.

5. *Illustrative Situations.*

Illustration 1: LR licenses a master disk of its software to LE allowing LE to make and distribute 10,000 copies. This is a nonexclusive license. The fee is $1 million. The cost of the disk is $5. LE wrongfully refuses the disk and repudiates the contract. Under (a)(1)(A), LR would recover $1 million less the $5, as also reduced by due allowance for (1) any substitute transaction made possible by this breach and (2) by any other failure to mitigate. However, (a)(1)(B) would ordinarily not apply since a second 10,000 copy license is not a substitute transaction if the license was not made possible by the breach. Recovery under subsection (a)(1)(C) is computed by assessing lost profit including reasonably attributable overhead.

Illustration 2: Same as Illustration 1, but the license was a worldwide exclusive license. On breach, LR makes an identical license with second LE for a fee of $900,000. This transaction was possible because the first exclusive license was canceled. LR recovery under subsection (a)(1)(B) is $100,000 less any net cost savings not accounted for in the second transaction. If there was no actual second license, but the market value for such a license was $800,000, the recovery is $200,000 less any net cost savings not accounted for in the hypothetical market value.

Illustration 3: LR grants an exclusive U.S. license to LE to distribute copies of LR's copyrighted digital encyclopedia. This is a ten year license at $50,000 per year. In Year 2, LE breaches and LR cancels. Recovery is the present value of the remaining contract fees with due allowance for any actual or hypothetical substitute transaction made possible by the breach.

6. *Remedies under Other Law.* The licensor may have remedies under other law. The primary source is intellectual property law. Breach introduces the possibility of an infringement claim if, for example, (a) the breach results in cancellation of the license and the licensee's continuing conduct is inconsistent with the licensor's property rights, or (b) the breach consists of acting outside the scope of the license and in violation of the intellectual property right. Intellectual property remedies do not displace contract remedies provisions since they deal with different issues. The two remedies may raise dual recovery issues in some cases. The general rule is that all remedies are cumulative, except that double recovery is not permitted.

2-809. LICENSEE'S DAMAGES.

Uniform Law Source: Uniform Commercial Code Sections 2A-518; 2A-519(1)(2). Revised.

Definitional Cross References. Section 102: "Consequential damages"; "Contract"; "Contract fee"; "Contractual use term"; "Direct damages"; "Good Faith"; "Incidental damages"; "Information"; "Informational rights"; "Licensee"; "Licensor"; "Present value"; "Receive"; "Term".

Official Comments:

1. *Scope and General Structure of the Section.* This section sets out damages measures for a licensee when the licensor breaches the contract. A licensee may choose among alternatives to fit the circumstances subject to the prohibition on double recovery. This rejects the hierarchy in Article 2 of the Uniform Commercial Code (1998 Official Text). . Under Section 807, damages related to events in the future at the time of the award are based on their present value.

2. *Direct and Consequential Damages.* Subsection (a)(1) measures direct damages. Direct damages are capped by the market value of the performance plus restitution of fees paid for which performance was not received. Market value refers to what would be charged in a similar transaction for the performance. Section 807 provides for when and where "market value" is determined.

"Direct damages" are the difference in market value between the performance promised and performance received, not counting lost expected benefits from anticipated use of the expected performance. If recoverable, those losses are consequential, not direct damages. This section rejects cases such as *Chatlos Systems, Inc. v. National Cash Register Corp.,* 670 F.2d 1304 (3d Cir. 1982) which, under a standard referring simply to "value", incorporate in direct damages an assessment of how valuable the use of the expected performance would have been to the aggrieved party.

All the damages recoverable under this section are subject to general principles of this Act. For example, Section 807 disallows recovery of consequential losses in some cases, including damage claims that are speculative or consequential loss associated with the content of published informational content. Recovery is also limited by the requirement that the aggrieved party act in a reasonable manner to avoid or reduce loss. Section 807.

3. *Computation.* Subsection (a) provides for recovery under the formulae stated in that section less expenses saved as a result of the breach to the extent not reflected in the formula.

a. Lost Value in Accepted Performance. Paragraph (a)(1)(A) provides for recovery for performance accepted and the acceptance is not revoked. Direct damages are measured by the difference in the contract price and the actual value received. If software with a value of $10,000 was to be delivered, but because of a defect, the value was $9,000, this paragraph yields a recovery of $1,000 if the licensee accepts the software. The value is generally measured by the contract fee. Recovery for any loss that exceeds that amount is consequential damages. This rejects decisions that compute direct damages as benefits expected from use, a concept more appropriately entailed in computation of consequential damages. This section, however, allows recovery based on the cost of repairs incurred to bring the product to the represented or warranted quality if those costs are commercially reasonable and incurred in good faith.

b. Performance not Received or Not Accepted. Paragraph (a)(1)(B) deals with damages in reference to a performance that has not been accepted by the licensee or as to which the acceptance has been revoked..

(i) Recovery of Fees. The licensee is entitled to recover any fee paid for which the performance was not received. Performance has not been received if the licensor fails to make a required delivery or repudiates, or if the licensee rightfully rejects or justifiably revokes acceptance, or if the performance was executory at the time the licensee justifiably canceled. This paragraph allows restitution of amounts paid for such undelivered performance.

(ii) Market and Cover. Paragraphs (a)(1)(B)(ii) and (B)(iii) parallel Article 2 of the Uniform Commercial Code (1998 Official Text) in computing direct damages by comparing contract price to either the market value of the performance not received or the cost of cover replacing that performance with a reasonable substitute. In each case, recovery is reduced by the amount of any expenses saved as a result of the breach. Section 807 requires that market value be determined as of the time and place for the performance.

Paragraph (B)(iii) establishes cover as a way to fix the amount of damages and avoid further loss. Recovery can be computed based on a commercially reasonable cover with the same contractual use terms as the original contract. In administering damage claims based on cover, however, courts must recognize differences between this remedy in goods transactions and in information commerce. If the information not delivered is obtainable from numerous sources, the similarity between goods and information is strong.

On the other hand, in many commercial contexts, the information may not be available from any other source. In such cases, obtaining a replacement product involves obtaining a different product. The different product is treated as cover only if the similarities are so close and without differences in cost that their use as a measure of damages is clearly appropriate. This allows cover through commercially reasonable substitutes, but does not allow cover with information products obtained under different contractual use terms than in the original contract. Use restrictions are important to defining the product itself and its price. They are sufficiently material that differences in such terms means that a different product is involved. Recovery when this occurs is left to "market value" standards. For example, while a licensee can cover for a breach in delivery of a word processing program by obtaining a different program as a commercially reasonable substitute, that version cannot be obtained under a perpetual license, where the original program was under a one year license.

c. Measured in any Reasonable Manner. Subsection (a)(1)(C) authorizes computation of direct damages in any manner that is reasonable. This provides a response to the many situations that cannot be predicted in advance. The measurement, while open-ended in computation technique,

is limited to the type of damages discussed here and by the cap on recovery of direct damages expressed in subsection (a)(1).

4. *Consequential and Incidental Damages.* The licensee may recover incidental and consequential damages in an appropriate case. If proven with reasonable certainty, damages can include lost profits.

5. *Illustrative Cases.*

Illustration 1: LE contracts for a 1,000 person site license for database software from LR. The contract fee is a $500,000 initial payment and $10,000 for each month of use. The license duration is two years. LE makes the first payment, but LR fails to deliver. LE cancels and obtains a substitute system under a three year contract for $500,000 and $11,000 per month. It is entitled to return of the $500,000 payment plus recovery of the difference between the contract price ($240,000 computed to present value) and the market price for the software. The court should consider to what extent this second transaction defines market value in light of differences in the terms of the license and the nature of the software and other relevant variables. The replacement does not qualify as cover because of the differences in the contract terms on duration of the license.

Illustration 2: Same facts as in Illustration 1, but after breach LE obtains a license for LR software from an authorized distributor (Jones) for a $600,000 initial fee under other terms identical to the LR contract. Since the new contract is for the same information under the same terms, LE has recovery of its initial payment, the $100,000 price difference, and any recoverable incidental or consequential damages.

Illustration 3: Assume that, rather than being completely defective, the database system lacks one element that was promised. While LE could refuse the software, it elects to accept the license. It sues for damages. The issue is establishing the difference in value between the system as contracted and the one delivered, in light of the contract price. Assume that the difference is $150,000. LE recovers that amount as direct damages, along with any recoverable incidental or consequential damages.

2-810. RECOUPMENT.

Uniform Law Source: Uniform Commercial Code Section 2-717 (1998 Official Text). Revised.

Definitional Cross References. Section 102: "Aggrieved party"; "Agreement"; "Contract"; "Material breach"; "Notify"; "Party".

Official Comments:

1. *Scope of the Section.* This section codifies the right of recoupment. Recoupment, as contrasted to set-off, allows self-help by recovering money owed through withholding payments due under the same contract. This section does not deal with rights of set-off. The section derives from Section 2-717 of the Uniform Commercial Code (1998 Official Text), but expands it.

2. *Basic Standard.* Recoupment permits one party to deduct from payments owed to the other, damages resulting from the other party's breach. The breach must be of the same contract under which the payment in question is being withheld. Exercise of the right requires notice to the other party. No formal language is required; any language that reasonably indicates the party's reason for withholding payment is sufficient. In the absence of notice, withholding payments is a breach and may also provide cause for insecurity and a right to demand assurances under Section 708.

3. *Non-material Breaches.* Subsection (b) limits the right in a cases of nonmaterial breach. This limit applies only if the breach was non-material as to both the particular performance and the entire contract. A failure to deliver a shipment is outside the limit since it is material as to that performance. On the other hand, if only a minor problem exists , the balance of interests shifts. In such contracts, allowing self-help reduction of payments creates a risk of over-reaching by the party withholding payment without a clear justification for doing so.

2-811. SPECIFIC PERFORMANCE.

Uniform Law Source: Uniform Commercial Code: Sections 2A-521; 2-716. Revised.

Definitional Cross References. Section 102: "Agreement"; "Contract"; "Court"; "Information"; "Informational Rights"; "Party"; "Term".

Official Comments:

1. *Scope of this Section.* This section adopts and clarifies the remedy of specific performance under Uniform Commercial Code. It allows the parties to contract for this remedy, but also requires that any award of the remedy protect confidential information and informational rights of the parties.

2. *Contracted For Remedy.* Subsection (a) allows the parties to contract for specific performance if a court can administer the remedy and performance is not an obligation to pay. This provides an efficient means for parties to avoid loss if one party, by not performing, attempts to convert a contract obligation into, in effect, an obligation to pay damages rather than perform.

3. *Judicial Remedy.* Subsection (a)(2) follows Uniform Commercial Code Article 2 (1998 Official Text). The standard thus differs from *Restatement (Second) of Contracts* § 357, *Introductory note.*

a. Personal Services. Specific performance cannot be ordered for a "personal services contract." An individual cannot be forced to perform against the individual's will. Determining what is a personal services contract requires a court to look at the nature of the agreement and what was to be provided pursuant to it. A contract for a named individual of superior skill or artistry to perform a particular task is a personal services contract. Breach gives a right to damages, but not a right to specific performance enforceable by contempt powers against the individual. If a corporation agrees to provide services, on the other hand, in many cases, the contractual obligation does not constitute personal services because any person in the corporation can perform. Of course, even if the contract does not involve personal services, this does not require or necessarily permit an award of specific performance.

b. Unique Subject Matter. Specific performance can only be ordered if the performance is "unique" or "in other appropriate circumstances." The test of uniqueness requires that a court examine the total commercial situation. The test incorporates a commercially realistic interpretation of the importance or uniqueness of the particular performance. Despite the often unique character of information provided by a particular source, however, respect for a licensor's property rights and confidentiality interests often precludes specific performance of an obligation to create or a right to continue use of the rights or property unless the need is compelling.

See *Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc.*, 756 F.2d 1043 (4th Cir. 1985). Specific performance may be appropriate to prevent misuse or wrongful disclosure of confidential material because the performance (non-disclosure) is commercially significant and cannot be adequately protected through an award of damages. Such an award is one potential illustration of the "other proper circumstances" referred to in this section and in current law.

4. *Conditioning the Order.* The terms of an order of specific performance are within the discretion of the court. While subsection (b) recognizes this, it provides an important protection for confidential information where performance might jeopardize interests in confidential information of a party. Confidentiality and informational rights must be adequately protected in any specific performance award.

2-812. LICENSOR'S RIGHT TO COMPLETE.

Uniform Law Source: Uniform Commercial Code: Sections 2A-524(2); 2-704(2) (1998, Revised Draft). Revised.

Definitional Cross References. Section 102: "Contract"; "Contractual use term"; "Copy"; "Information"; "Licensee"; "Licensor"; "Party."

Official Comments:

1. *Scope of the Section.* This section parallels Uniform Commercial Code Section 2-704 (1998, Revised Draft). It gives several options to the licensor in proceeding after breach by the licensee. The licensor's choice is constrained by the general duty to mitigate damages.

2. *Right to Identify Copies to the Contract.* The right to identify conforming copies to the contract is applicable primarily to situations where the licensor intends to rely on the measure of damages that involves comparison of the contract fee with the fee received in a substitute transaction for the same information. It will be less common in computer information transactions than in sales of goods because license breaches ordinarily do not result in this type of damages computation.

3. *Right to Complete Unfinished Information.* The licensor can complete the information or exercise its other options under subsection (a)(2) in the exercise of reasonable commercial judgment in light of the facts as they appear at the time. If the question of whether the action was commercially reasonable is contested, the burden is on the licensee to show the commercially unreasonable nature of the licensor's action just as it would be under Section 807, if the licensor elected not to complete and the allegation is that the licensor failed to mitigate loss.

2-813. LICENSEE'S RIGHT TO CONTINUE USE.

Definitional Cross References. Section 102: "Cancel"; "Contract"; "Contract fee"; "Contractual use term"; "Information"; "Informational Rights"; "Licensee"; "Licensor"; "Term".

Official Comment:

This section allows the licensee, in an appropriate case, to elect between canceling the license or retaining the contractual rights and obligations, while pursuing other remedies. It can continue use and sue for breach if it elects to accept a flawed performance and not cancel the contract. Cancellation, in contrast, eliminates all rights of use under the license. Section 802. If the licensee elects to continue use, it remains bound by the contract as if no breach occurred, except, of course, for its right to a remedy for breach.

2-814. RIGHT TO DISCONTINUE ACCESS.

Definitional Cross References. Section 102: "Access contract"; "Agreement"; "Party"; "Person". Section 701: "Material breach."

Official Comments:

1. *Scope of Section.* This section deals with the right in an access contract to stop performance by denying further access to the other party.

2. *Right to Deny Access.* An access provider may discontinue access without judicial authorization or prior notice in the event of material breach or, if the contract so provides. The agreement entails permitted electronic access to a facility controlled by the licensor which can be ended immediately on breach. The right to discontinue corresponds to common law which treats such contracts as subject to cancellation at will by the party who controls the facility even in absence of any breach, unless the contract otherwise provides. *Ticketron Ltd. Partnership v. Flip Side, Inc.,* No. 92-C-0911, 1993 WL 214164 (ND Ill. June 17, 1993).

3. *Not Retaking Transfers.* This section does not give the licensor a right to retake transfers already made without judicial action, but merely to stop future performance. Rights with respect to information already in possession or control of the licensee at the time of discontinuance are dealt with elsewhere.

2-815. RIGHT TO POSSESSION AND TO PREVENT USE.

Uniform Law Source: Uniform Commercial Code: Sections 2A-525, 2A-526; 9-503 (1998 Official Text).

Definitional Cross References. Section 102: "Cancellation"; "Contract"; "Contractual use term"; "Course of Performance"; "Court"; "Information"; "Informational Rights"; "License"; "Licensee"; "Licensor"; "Party".

Official Comments:

1. *Scope of the Section.* This section applies only to licenses properly canceled for breach. The section recognizes that the aggrieved party has a right to recover the licensed information and prevent further use by the breaching party. The remedies are analogous to Article 2A of the Uniform Commercial Code (1998 Official Text).

2. *Rights Recognized.* In a license, the licensor retains over-riding rights in the information. Cancellation triggers an immediate right to prevent further use and retake the property conditionally made available to the licensee. The aggrieved party can obtain 1) possession of all copies of the information, and 2) when appropriate, an injunction against further use. On cancellation, the injured party has a right to preclude any further benefits to the breaching party resulting from the licensed information. Merely returning copies may not achieve that result. The rights here, of course, apply only to information or copies provided under the license or made from licensed material. Information independently and properly obtained from another source does not come within the provisions of this section.

3. *Self-help.* Subsection (b) allows a right of self-help under standards consistent with Article 2A and Article 9 of the Uniform Commercial Code (1998 Official Text). Self-help cannot be used unless there was a breach and proper cancellation, and its use self-help does not "breach the peace" or create a foreseeable risk of personal injury or significant physical damage to information or property other than the licensed information. Article 9 decisions are relevant on the issue of breach of the peace.

4. *Expedited Hearing.* Subsection (d) gives each party a right to an expedited hearing to enforce or protect rights relating to possession and restrictions on use. This enables early review to reduce potentially significant risks for the licensee and the licensor, e.g., the risk to the licensee that a slow judicial process may cause an increased harm by inducing a licensor to use self-help to enforce rights, and the risk to the licensor that the delay may cause serious economic or other harm. The section does not specify the timing required. This is left to state procedural law.

5. *Identifiability.* Under subsection (e) there must be some identifiable thing with reference to which possessory rights can be applied. A right to possession cannot exist if the information has been so commingled as to be unidentifiable. This includes, for example, cases where data are thoroughly

intermingled with data of the other party **and** that intermingling occurs in ordinary performance under the license. In such cases, repossession is impossible due to the expected performance under the contract.

This limitation does not apply to the right to prevent use. For example, if trade secrets were provided to the licensee under contractual use terms, the ability to prevent further use hinges solely on whether a particular activity can be identified as involving use of the information. If an image, trademark, name or similar material is inseparable from other property of the party in breach, that does not preclude the injured party from preventing further use of the information by the party in breach. Thus, a license that results in use of an image in a video game by the party in breach does not prevent the licensor from barring use of the image after breach even if the image is inseparable from the game. Of course, as to end users of the game, the prior authorized distribution of copies containing the image is not impaired by subsequent cancellation.

2-816. ELECTRONIC SELF-HELP.

Definitional Cross References. Section 102: "Cancellation"; "Consequential damages"; "Computer information"; "Copy"; "Court"; "Electronic"; "Incidental damages"; "Information"; "License"; "Licensee"; "Licensor"; "Notice"; "Party"; "Person"; "Record"; "Term". Section 112: "Manifesting assent". Section 114: "Reason to know".

Official Comments:

1. *Scope of the Section.* This section restricts the right of a licensor to prevent use by electronic means of the computer information after material breach and cancellation of a license. Under other law, the limits, if any, on electronic self-help right under state law are uncertain. This Act does not deal with rights arising under Article 9 or Articles 2 or 2A of the Uniform Commercial Code. There may also be federal issues under the Communications Privacy Act and under the Copyright Act regarding copyright security devices, but this Act does not alter federal law. Section 102 ("termination").

The section does not deal with use of electronic restraints to enforce contract terms by limiting the licensee's performance to the terms of the contract. Similarly, the section only deals with when a contract is canceled for breach, it does not apply to the use of electronics on termination of the license by its own terms or otherwise without breach.

2. *Nature of the Restrictions.* While electronic self-help is an efficient means of enforcing rights on breach that may be vital to protecting a licensor, the remedy requires restrictions to prevent abuse and to ensure that there is an opportunity to have issues resolved in court before action occurs. The basic restrictions created by this section include:

- a requirement of assent in the original agreement to the *term* regarding availability of the right;
- a requirement of advance notice of no less that 15 days before the exercise of the right;
- a prohibition on any exercise of the right in certain cases, including any case where there is a threat of personal injury or of severe harm to the public interest; and
- a non-waivable right to consequential damages for any wrongful use of electronic self-help.

a. *Term of Agreement.* Electronic self-help is not permitted unless a term of the license expressly authorizes it and the licensee manifests assent to that term. Assent to the term requires that there be action with respect to the term itself, not merely general assent to the license. The electronic self-help option must be created with notice of the term by the licensee.

Subsection (c) requires that the licensee specify the person to whom notice of intended use of electronic self-help is to be sent. "Person" in this context does not necessarily refer to an individual, but includes designation of an office, such as the office of general counsel, as the designated recipient.

b. *Notice of Exercise.* Under subsection (d), even if authorized by the license, electronic self-help cannot be used unless the licensor gives a minimum of 15 days advance notice of its intent to exercise the right, which notice must state the nature of the claimed breach on which the right is based and the name and location of a person to which the licensee can communicate regarding the problem. The notice period serves several purposes. It ensures that the licensee will be aware of the problem and the risk of electronic self-help with sufficient time to react. The reaction may be an attempt to solve the problem or resort to the courts to forestall use of the remedy. Also, of course, during the notice period, if the licensee elects not to contest the cancellation, it will be able to make necessary, lawful adjustments to minimize the adverse effects of its breach on its own operations.

c. *Exercise Prohibited.* Electronic self-help is exercised pursuant to Section 815(b) and, thus, cannot occur unless the conditions of that subsection are met. There can be no electronic self-help

where a breach of the peace would result or where there is a threat of foreseeable damage of personal injury or significant physical damage to property other than the licensed information. In addition, under subsection (f), electronic self-help is barred if there is reason to know its use will result in substantial injury or harm to the public health or safety or grave harm to the public interest substantially affecting third parties not involved in the dispute. One illustration is where the licensed software is integral to the funds transfer or payment systems of a banking institution or where it pertains to national security systems. In such cases, the peremptory remedy of electronic self-help threatens disruption that far exceeds the benefits of allowing its use.

In cases where electronic self-help is prohibited, of course, the licensor's appropriate remedy is by a judicial action to enforce its rights. This section gives each party a right of rapid access to court. In a case where breach justifies cancellation, judicial remedies under Section 815 are appropriate.

3. *Damages for Wrongful Use.* Subsection (e) confirms that wrongful use of electronic self-help is a breach of contract entitling the injured party to damages under this Act. Wrongful use may also entitle the injured party to other remedies, but these are outside the scope of this Act.

In the event of wrongful use, the aggrieved party may recover direct, incidental and consequential damages as appropriate. In two contexts, the right to consequential damages cannot be altered by agreement. One is when the licensor had reason to know that use of the electronic self-help remedy risked the type of general public or third party injuries referred to in subsection (f). The second context arises where the licensee gave a good faith notice of the general nature and magnitude of damages that might result from such action. The notice must be in good faith, but the section does not bind the licensee to only those damages indicated in its notice.

4. *Expedited Hearing.* Ultimately in cases of doubt as to the propriety of electronic self-help, the matter should be decided by the court before the fact. Subsection (g) follows this view, giving each party a right to prompt consideration of the issue in court.

5. *Non-waiver.* The rights and obligations under this section cannot be waived by agreement, except for additional provisions that are more favorable than the section to the licensee. A contractual provision precluding use of electronic self-help in all cases is more favorable to the licensee and is enforceable (subject to the limitations of this Act on enforceability of terms, such as unconscionability).

ARTICLE 2A - LEASES

PART 1. GENERAL PROVISIONS.

2A-101. SHORT TITLE.

This Article shall be known and may be cited as the Uniform Commercial Code - Leases.

2A-102. SCOPE.

This Article applies to any transaction, regardless of form, that creates a lease.

2A-103. DEFINITIONS AND INDEX OF DEFINITIONS.

(1) In this Article unless the context otherwise requires:

(a) "**Buyer in ordinary course of business**" means a person who in good faith and without knowledge that the sale to him [or her] is in violation of the ownership rights or security interest or leasehold interest of a third party in the goods, buys in ordinary course from a person in the business of selling goods of that kind but does not include a pawnbroker. "Buying" may be for cash or by exchange of other property or on secured or unsecured credit and includes acquiring goods or documents of title under a pre-existing contract for sale but does not include a transfer in bulk or as security for or in total or partial satisfaction of a money debt.

(b) "**Cancellation**" occurs when either party puts an end to the lease contract for default by the other party.

(c) "**Commercial unit**" means such a unit of goods as by commercial usage is a single whole for purposes of lease and division of which materially impairs its character or value on the market or in use. A commercial unit may be a single article, as a machine, or a set of articles, as a suite of furniture or a line of machinery, or a quantity, as a gross or carload, or any other unit treated in use or in the relevant market as a single whole.

(d) "**Conforming**" goods or performance under a lease contract means goods or performance that are in accordance with the obligations under the lease contract.

(e) "**Consumer lease**" means a lease that a lessor regularly engaged in the business of leasing or selling makes to a lessee who is an individual and who takes under the lease primarily for a

personal, family, or household purpose [, if the total payments to be made under the lease contract, excluding payments for options to renew or buy, do not exceed $_____].

(f) "**Fault**" means wrongful act, omission, breach, or default.

(g) "**Finance lease**" means a lease with respect to which:

(i) the lessor does not select, manufacture, or supply the goods;

(ii) the lessor acquires the goods or the right to possession and use of the goods in connection with the lease; and

(iii) one of the following occurs:

(A) the lessee receives a copy of the contract by which the lessor acquired the goods or the right to possession and use of the goods before signing the lease contract ;

(B) the lessee's approval of the contract by which the lessor acquired the goods or the right to possession and use of the goods is a condition to effectiveness of the lease contract;

(C) the lessee, before signing the lease contract, receives an accurate and complete statement designating the promises and warranties, and any disclaimers of warranties, limitations or modifications of remedies, or liquidated damages, including those of a third party, such as the manufacturer of the goods, provided to the lessor by the person supplying the goods in connection with or as part of the contract by which the lessor acquired the goods or the right to possession and use of the goods; or

(D) if the lease is not a consumer lease, the lessor, before the lessee signs the lease contract, informs the lessee in writing (a) of the identity of the person supplying the goods to the lessor, unless the lessee has selected that person and directed the lessor to acquire the goods or the right to possession and use of the goods from that person, (b) that the lessee is entitled under this Article to the promises and warranties, including those of any third party, provided to the lessor by the person supplying the goods in connection with or as part of the contract by which the lessor acquired the goods or the right to possession and use of the goods, and (c) that the lessee may communicate with the person supplying the goods to the lessor and receive an accurate and complete statement of those promises and warranties, including any disclaimers and limitations of them or of remedies.

(h) "**Goods**" means all things that are movable at the time of identification to the lease contract, or are fixtures (Section 2A-309), but the term does not include money, documents, instruments, accounts, chattel paper, general intangibles, or minerals or the like, including oil and gas, before extraction. The term also includes the unborn young of animals.

(i) "**Installment lease contract**" means a lease contract that authorizes or requires the delivery of goods in separate lots to be separately accepted, even though the lease contract contains a clause "each delivery is a separate lease" or its equivalent.

(j) "**Lease**" means a transfer of the right to possession and use of goods for a term in return for consideration, but a sale, including a sale on approval or a sale or return, or retention or creation of a security interest is not a lease. Unless the context clearly indicates otherwise, the term includes a sublease.

(k) "**Lease agreement**" means the bargain, with respect to the lease, of the lessor and the lessee in fact as found in their language or by implication from other circumstances including course of dealing or usage of trade or course of performance as provided in this Article. Unless the context clearly indicates otherwise, the term includes a sublease agreement.

(l) "**Lease contract**" means the total legal obligation that results from the lease agreement as affected by this Article and any other applicable rules of law. Unless the context clearly indicates otherwise, the term includes a sublease contract.

(m) "**Leasehold interest**" means the interest of the lessor or the lessee under a lease contract. (n)

"**Lessee**" means a person who acquires the right to possession and use of goods under a lease. Unless the context clearly indicates otherwise, the term includes a sublessee.

(o) "**Lessee in ordinary course of business**" means a person who in good faith and without knowledge that the lease to him [or her] is in violation of the ownership rights or security interest or leasehold interest of a third party in the goods leases in ordinary course from a person in the business of selling or leasing goods of that kind but does not include a pawnbroker. "Leasing" may be for cash or by exchange of other property or on secured or unsecured credit and includes

acquiring goods or documents of title under a pre-existing lease contract but does not include a transfer in bulk or as security for or in total or partial satisfaction of a money debt.

(p) "**Lessor**" means a person who transfers the right to possession and use of goods under a lease. Unless the context clearly indicates otherwise, the term includes a sublessor.

(q) "**Lessor's residual interest**" means the lessor's interest in the goods after expiration, termination, or cancellation of the lease contract.

(r) "**Lien**" means a charge against or interest in goods to secure payment of a debt or performance of an obligation, but the term does not include a security interest.

(s) "**Lot**" means a parcel or a single article that is the subject matter of a separate lease or delivery, whether or not it is sufficient to perform the lease contract.

(t) "**Merchant lessee**" means a lessee that is a merchant with respect to goods of the kind subject to the lease.

(u) "**Present value**" means the amount as of a date certain of one or more sums payable in the future, discounted to the date certain. The discount is determined by the interest rate specified by the parties if the rate was not manifestly unreasonable at the time the transaction was entered into; otherwise, the discount is determined by a commercially reasonable rate that takes into account the facts and circumstances of each case at the time the transaction was entered into.

(v) "**Purchase**" includes taking by sale, lease, mortgage, security interest, pledge, gift, or any other voluntary transaction creating an interest in goods.

(w) "**Sublease**" means a lease of goods the right to possession and use of which was acquired by the lessor as a lessee under an existing lease.

(x) "**Supplier**" means a person from whom a lessor buys or leases goods to be leased under a finance lease.

(y) "**Supply contract**" means a contract under which a lessor buys or leases goods to be leased.

(z) "**Termination**" occurs when either party pursuant to a power created by agreement or law puts an end to the lease contract otherwise than for default.

(2) Other definitions applying to this Article and the sections in which they appear are:

"**Accessions**".	Section 2A-310(1).
"**Construction mortgage**".	Section 2A-309(1)(d).
"**Encumbrance**".	Section 2A-309(1)(e).
"**Fixtures**".	Section 2A-309(1)(a).
"**Fixture filing**".	Section 2A-309(1)(b).
"**Purchase money lease**".	Section 2A-309(1)(c).

(3) The following definitions in other Articles apply to this Article:

"**Account**".	Section 9-102(a)(2).
"**Between merchants**".	Section 2-104(3).
"**Buyer**".	Section 2-103(1)(a).
"**Chattel paper**".	Section 9-102(a)(11).
"**Consumer goods**".	Section 9-102(a)(23).
"**Document**".	Section 9-102(a)(30).
"**Entrusting**".	Section 2-403(3).
"**General intangible**".	Section 9-102(a)(42).
"**Instrument**".	Section 9-102(a)(47).
"**Merchant**".	Section 2-104(1).
"**Mortgage**".	Section 9-102(a)(55).
"**Pursuant to commitment**".	Section 9-102(a)(68).
"**Receipt**".	Section 2-103(1)(c).
"**Sale**".	Section 2-106(1).

"**Sale on approval**".	Section 2-326. "**Sale**
or return".	Section 2-326.
"**Seller**".	Section 2-103(1)(d).

(4) In addition, Article 1 contains general definitions and principles of construction and interpretation applicable throughout this Article.

2A-104. LEASES SUBJECT TO OTHER LAW.

(1) A lease, although subject to this Article, is also subject to any applicable:

(a) certificate of title statute of this State: (list any certificate of title statutes covering automobiles, trailers, mobile homes, boats, farm tractors, and the like);

(b) certificate of title statute of another jurisdiction (Section 2A-105); or

(c) consumer protection statute of this State, or final consumer protection decision of a court of this State existing on the effective date of this Article.

(2) In case of conflict between this Article, other than Sections 2A-105, 2A-304(3), and 2A-305(3), and a statute or decision referred to in subsection (1), the statute or decision controls.

(3) Failure to comply with an applicable law has only the effect specified therein.

2A-105. TERRITORIAL APPLICATION OF ARTICLE TO GOODS COVERED BY CERTIFICATE OF TITLE.

Subject to the provisions of Sections 2A-304(3) and 2A-305(3), with respect to goods covered by a certificate of title issued under a statute of this State or of another jurisdiction, compliance and the effect of compliance or noncompliance with a certificate of title statute are governed by the law (including the conflict of laws rules) of the jurisdiction issuing the certificate until the earlier of (a) surrender of the certificate, or (b) four months after the goods are removed from that jurisdiction and thereafter until a new certificate of title is issued by another jurisdiction.

2A-106. LIMITATION ON POWER OF PARTIES TO CONSUMER LEASE TO CHOOSE APPLICABLE LAW AND JUDICIAL FORUM.

(1) If the law chosen by the parties to a consumer lease is that of a jurisdiction other than a jurisdiction in which the lessee resides at the time the lease agreement becomes enforceable or within 30 days thereafter or in which the goods are to be used, the choice is not enforceable.

(2) If the judicial forum chosen by the parties to a consumer lease is a forum that would not otherwise have jurisdiction over the lessee, the choice is not enforceable.

2A-107. WAIVER OR RENUNCIATION OF CLAIM OR RIGHT AFTER DEFAULT.

Any claim or right arising out of an alleged default or breach of warranty may be discharged in whole or in part without consideration by a written waiver or renunciation signed and delivered by the aggrieved party.

2A-108. UNCONSCIONABILITY.

(1) If the court as a matter of law finds a lease contract or any clause of a lease contract to have been unconscionable at the time it was made the court may refuse to enforce the lease contract, or it may enforce the remainder of the lease contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result.

(2) With respect to a consumer lease, if the court as a matter of law finds that a lease contract or any clause of a lease contract has been induced by unconscionable conduct or that unconscionable conduct has occurred in the collection of a claim arising from a lease contract, the court may grant appropriate relief.

(3) Before making a finding of unconscionability under subsection (1) or (2), the court, on its own motion or that of a party, shall afford the parties a reasonable opportunity to present evidence as to the setting, purpose, and effect of the lease contract or clause thereof, or of the conduct.

(4) In an action in which the lessee claims unconscionability with respect to a consumer lease:

(a) If the court finds unconscionability under subsection (1) or (2), the court shall award reasonable attorney's fees to the lessee.

(b) If the court does not find unconscionability and the lessee claiming unconscionability has brought or maintained an action he [or she] knew to be groundless, the court shall award reasonable attorney's fees to the party against whom the claim is made.

(c) In determining attorney's fees, the amount of the recovery on behalf of the claimant under subsections (1) and (2) is not controlling.

2A-109. OPTION TO ACCELERATE AT WILL.

(1) A term providing that one party or his [or her] successor in interest may accelerate payment or performance or require collateral or additional collateral "at will" or "when he [or she] deems himself [or herself] insecure" or in words of similar import must be construed to mean that he [or she] has power to do so only if he [or she] in good faith believes that the prospect of payment or performance is impaired.

(2) With respect to a consumer lease, the burden of establishing good faith under subsection (1) is on the party who exercised the power; otherwise the burden of establishing lack of good faith is on the party against whom the power has been exercised.

PART 2. FORMATION AND CONSTRUCTION OF LEASE CONTRACT [Table of Contents]

2A-201. STATUTE OF FRAUDS.

(1) A lease contract is not enforceable by way of action or defense unless:

(a) the total payments to be made under the lease contract, excluding payments for options to renew or buy, are less than $1,000; or

(b) there is a writing, signed by the party against whom enforcement is sought or by that party's authorized agent, sufficient to indicate that a lease contract has been made between the parties and to describe the goods leased and the lease term.

(2) Any description of leased goods or of the lease term is sufficient and satisfies subsection (1)(b), whether or not it is specific, if it reasonably identifies what is described.

(3) A writing is not insufficient because it omits or incorrectly states a term agreed upon, but the lease contract is not enforceable under subsection (1)(b) beyond the lease term and the quantity of goods shown in the writing.

(4) A lease contract that does not satisfy the requirements of subsection (1), but which is valid in other respects, is enforceable:

(a) if the goods are to be specially manufactured or obtained for the lessee and are not suitable for lease or sale to others in the ordinary course of the lessor's business, and the lessor, before notice of repudiation is received and under circumstances that reasonably indicate that the goods are for the lessee, has made either a substantial beginning of their manufacture or commitments for their procurement;

(b) if the party against whom enforcement is sought admits in that party's pleading, testimony or otherwise in court that a lease contract was made, but the lease contract is not enforceable under this provision beyond the quantity of goods admitted; or

(c) with respect to goods that have been received and accepted by the lessee.

(5) The lease term under a lease contract referred to in subsection (4) is:

(a) if there is a writing signed by the party against whom enforcement is sought or by that party's authorized agent specifying the lease term, the term so specified;

(b) if the party against whom enforcement is sought admits in that party's pleading, testimony, or otherwise in court a lease term, the term so admitted; or

(c) a reasonable lease term.

2A-202. FINAL WRITTEN EXPRESSION: PAROL OR EXTRINSIC EVIDENCE.

Terms with respect to which the confirmatory memoranda of the parties agree or which are otherwise set forth in a writing intended by the parties as a final expression of their agreement with respect to such terms as are included therein may not be contradicted by evidence of any prior agreement or of a contemporaneous oral agreement but may be explained or supplemented:

(a) by course of dealing or usage of trade or by course of performance; and

(b) by evidence of consistent additional terms unless the court finds the writing to have been intended also as a complete and exclusive statement of the terms of the agreement.

2A-203. SEALS INOPERATIVE.

The affixing of a seal to a writing evidencing a lease contract or an offer to enter into a lease contract does not render the writing a sealed instrument and the law with respect to sealed instruments does not apply to the lease contract or offer.

2A-204. FORMATION IN GENERAL.

(1) A lease contract may be made in any manner sufficient to show agreement, including conduct by both parties which recognizes the existence of a lease contract.

(2) An agreement sufficient to constitute a lease contract may be found although the moment of its making is undetermined.

(3) Although one or more terms are left open, a lease contract does not fail for indefiniteness if the parties have intended to make a lease contract and there is a reasonably certain basis for giving an appropriate remedy.

2A-205. FIRM OFFERS.

An offer by a merchant to lease goods to or from another person in a signed writing that by its terms gives assurance it will be held open is not revocable, for lack of consideration, during the time stated or, if no time is stated, for a reasonable time, but in no event may the period of irrevocability exceed 3 months. Any such term of assurance on a form supplied by the offeree must be separately signed by the offeror.

2A-206. OFFER AND ACCEPTANCE IN FORMATION OF LEASE CONTRACT.

(1) Unless otherwise unambiguously indicated by the language or circumstances, an offer to make a lease contract must be construed as inviting acceptance in any manner and by any medium reasonable in the circumstances.

(2) If the beginning of a requested performance is a reasonable mode of acceptance, an offeror who is not notified of acceptance within a reasonable time may treat the offer as having lapsed before acceptance.

2A-208. MODIFICATION, RESCISSION AND WAIVER.

(1) An agreement modifying a lease contract needs no consideration to be binding.

(2) A signed lease agreement that excludes modification or rescission except by a signed writing may not be otherwise modified or rescinded, but, except as between merchants, such a requirement on a form supplied by a merchant must be separately signed by the other party.

(3) Although an attempt at modification or rescission does not satisfy the requirements of subsection (2), it may operate as a waiver.

(4) A party who has made a waiver affecting an executory portion of a lease contract may retract the waiver by reasonable notification received by the other party that strict performance will be required of any term waived, unless the retraction would be unjust in view of a material change of position in reliance on the waiver.

2A-209. LESSEE UNDER FINANCE LEASE AS BENEFICIARY OF SUPPLY CONTRACT.

(1) The benefit of a supplier's promises to the lessor under the supply contract and of all warranties, whether express or implied, including those of any third party provided in connection with or as part of the supply contract, extends to the lessee to the extent of the lessee's leasehold interest under a finance lease related to the supply contract, but is subject to the terms of the warranty and of the supply contract and all defenses or claims arising therefrom.

(2) The extension of the benefit of a supplier's promises and of warranties to the lessee (Section 2A-209(1)) does not: (i) modify the rights and obligations of the parties to the supply contract, whether arising therefrom or otherwise, or (ii) impose any duty or liability under the supply contract on the lessee.

(3) Any modification or rescission of the supply contract by the supplier and the lessor is effective between the supplier and the lessee unless, before the modification or rescission, the supplier has received notice that the lessee has entered into a finance lease related to the supply contract. If the modification or rescission is effective between the supplier and the lessee, the lessor is deemed to have assumed, in addition to the obligations of the lessor to the lessee under the lease contract, promises of the supplier to the lessor and warranties that were so modified or rescinded as they existed and were available to the lessee before modification or rescission.

(4) In addition to the extension of the benefit of the supplier's promises and of warranties to the lessee under subsection (1), the lessee retains all rights that the lessee may have against the supplier which arise from an agreement between the lessee and the supplier or under other law.

2A-210. EXPRESS WARRANTIES.

(1) Express warranties by the lessor are created as follows:

(a) Any affirmation of fact or promise made by the lessor to the lessee which relates to the goods and becomes part of the basis of the bargain creates an express warranty that the goods will conform to the affirmation or promise.

(b) Any description of the goods which is made part of the basis of the bargain creates an express warranty that the goods will conform to the description.

(c) Any sample or model that is made part of the basis of the bargain creates an express warranty that the whole of the goods will conform to the sample or model.

(2) It is not necessary to the creation of an express warranty that the lessor use formal words, such as "warrant" or "guarantee," or that the lessor have a specific intention to make a warranty, but an affirmation merely of the value of the goods or a statement purporting to be merely the lessor's opinion or commendation of the goods does not create a warranty.

2A-211. WARRANTIES AGAINST INTERFERENCE AND AGAINST INFRINGEMENT; LESSEE'S OBLIGATION AGAINST INFRINGEMENT.

(1) There is in a lease contract a warranty that for the lease term no person holds a claim to or interest in the goods that arose from an act or omission of the lessor, other than a claim by way of infringement or the like, which will interfere with the lessee's enjoyment of its leasehold interest.

(2) Except in a finance lease there is in a lease contract by a lessor who is a merchant regularly dealing in goods of the kind a warranty that the goods are delivered free of the rightful claim of any person by way of infringement or the like.

(3) A lessee who furnishes specifications to a lessor or a supplier shall hold the lessor and the supplier harmless against any claim by way of infringement or the like that arises out of compliance with the specifications.

2A-212. IMPLIED WARRANTY OF MERCHANTABILITY.

(1) Except in a finance lease, a warranty that the goods will be merchantable is implied in a lease contract if the lessor is a merchant with respect to goods of that kind.

(2) Goods to be merchantable must be at least such as

(a) pass without objection in the trade under the description in the lease agreement;

(b) in the case of fungible goods, are of fair average quality within the description;

(c) are fit for the ordinary purposes for which goods of that type are used;

(d) run, within the variation permitted by the lease agreement, of even kind, quality, and quantity within each unit and among all units involved;

(e) are adequately contained, packaged, and labeled as the lease agreement may require; and

(f) conform to any promises or affirmations of fact made on the container or label.

(3) Other implied warranties may arise from course of dealing or usage of trade.

2A-213. IMPLIED WARRANTY OF FITNESS FOR PARTICULAR PURPOSE.

Except in a finance lease, if the lessor at the time the lease contract is made has reason to know of any particular purpose for which the goods are required and that the lessee is relying on the lessor's skill or judgment to select or furnish suitable goods, there is in the lease contract an implied warranty that the goods will be fit for that purpose.

2A-214. EXCLUSION OR MODIFICATION OF WARRANTIES.

(1) Words or conduct relevant to the creation of an express warranty and words or conduct tending to negate or limit a warranty must be construed wherever reasonable as consistent with each other; but, subject to the provisions of Section 2A-202 on parol or extrinsic evidence, negation or limitation is inoperative to the extent that the construction is unreasonable.

(2) Subject to subsection (3), to exclude or modify the implied warranty of merchantability or any part of it the language must mention "merchantability", be by a writing, and be conspicuous. Subject to subsection (3), to exclude or modify any implied warranty of fitness the exclusion must be by a writing and be conspicuous. Language to exclude all implied warranties of fitness is sufficient if it is in writing, is conspicuous and states, for example, "There is no warranty that the goods will be fit for a particular purpose".

(3) Notwithstanding subsection (2), but subject to subsection (4),

(a) unless the circumstances indicate otherwise, all implied warranties are excluded by expressions like "as is," or "with all faults," or by other language that in common understanding calls the lessee's attention to the exclusion of warranties and makes plain that there is no implied warranty, if in writing and conspicuous;

(b) if the lessee before entering into the lease contract has examined the goods or the sample or model as fully as desired or has refused to examine the goods, there is no implied warranty with regard to defects that an examination ought in the circumstances to have revealed; and

(c) an implied warranty may also be excluded or modified by course of dealing, course of performance, or usage of trade.

(4) To exclude or modify a warranty against interference or against infringement (Section 2A-211) or any part of it, the language must be specific, be by a writing, and be conspicuous, unless the circumstances, including course of performance, course of dealing, or usage of trade, give the lessee reason to know that the goods are being leased subject to a claim or interest of any person.

2A-215. CUMULATION AND CONFLICT OF WARRANTIES EXPRESS OR IMPLIED.

Warranties, whether express or implied, must be construed as consistent with each other and as cumulative, but if that construction is unreasonable, the intention of the parties determines which warranty is dominant. In ascertaining that intention the following rules apply:

(a) Exact or technical specifications displace an inconsistent sample or model or general language of description.

(b) A sample from an existing bulk displaces inconsistent general language of description.

(c) Express warranties displace inconsistent implied warranties other than an implied warranty of fitness for a particular purpose.

2A-216. THIRD-PARTY BENEFICIARIES OF EXPRESS AND IMPLIED WARRANTIES.

Alternative A

A warranty to or for the benefit of a lessee under this Article, whether express or implied, extends to any natural person who is in the family or household of the lessee or who is a guest in the lessee's home if it is reasonable to expect that such person may use, consume, or be affected by the goods and who is injured in person by breach of the warranty. This section does not displace principles of law and equity that extend a warranty to or for the benefit of a lessee to other persons. The operation of this section may not be excluded, modified, or limited, but an exclusion, modification, or limitation of the warranty, including any with respect to rights and remedies, effective against the lessee is also effective against any beneficiary designated under this section.

Alternative B

A warranty to or for the benefit of a lessee under this Article, whether express or implied, extends to any natural person who may reasonably be expected to use, consume, or be affected by the goods and who is injured in person by breach of the warranty. This section does not displace principles of law and equity that extend a warranty to or for the benefit of a lessee to other persons. The operation of this section may not be excluded, modified, or limited, but an exclusion, modification, or limitation of the warranty, including any with respect to rights and remedies, effective against the lessee is also effective against the beneficiary designated under this section.

Alternative C

A warranty to or for the benefit of a lessee under this Article, whether express or implied, extends to any person who may reasonably be expected to use, consume, or be affected by the goods and who is injured by breach of the warranty. The operation of this section may not be excluded, modified, or limited with respect to injury to the person of an individual to whom the warranty extends, but an exclusion, modification, or limitation of the warranty, including any with respect to rights and remedies, effective against the lessee is also effective against the beneficiary designated under this section.

2A-217. IDENTIFICATION.

Identification of goods as goods to which a lease contract refers may be made at any time and in any manner explicitly agreed to by the parties. In the absence of explicit agreement, identification occurs:

(a) when the lease contract is made if the lease contract is for a lease of goods that are existing and identified;

(b) when the goods are shipped, marked, or otherwise designated by the lessor as goods to which the lease contract refers, if the lease contract is for a lease of goods that are not existing and identified; or

(c) when the young are conceived, if the lease contract is for a lease of unborn young of animals.

2A-218. INSURANCE AND PROCEEDS.

(1) A lessee obtains an insurable interest when existing goods are identified to the lease contract even though the goods identified are nonconforming and the lessee has an option to reject them.

(2) If a lessee has an insurable interest only by reason of the lessor's identification of the goods, the lessor, until default or insolvency or notification to the lessee that identification is final, may substitute other goods for those identified.

(3) Notwithstanding a lessee's insurable interest under subsections (1) and (2), the lessor retains an insurable interest until an option to buy has been exercised by the lessee and risk of loss has passed to the lessee.

(4) Nothing in this section impairs any insurable interest recognized under any other statute or rule of law.

(5) The parties by agreement may determine that one or more parties have an obligation to obtain and pay for insurance covering the goods and by agreement may determine the beneficiary of the proceeds of the insurance.

2A-219. RISK OF LOSS.

(1) Except in the case of a finance lease, risk of loss is retained by the lessor and does not pass to the lessee. In the case of a finance lease, risk of loss passes to the lessee.

(2) Subject to the provisions of this Article on the effect of default on risk of loss (Section 2A-220), if risk of loss is to pass to the lessee and the time of passage is not stated, the following rules apply:

(a) If the lease contract requires or authorizes the goods to be shipped by carrier

(i) and it does not require delivery at a particular destination, the risk of loss passes to the lessee when the goods are duly delivered to the carrier; but

(ii) if it does require delivery at a particular destination and the goods are there duly tendered while in the possession of the carrier, the risk of loss passes to the lessee when the goods are there duly so tendered as to enable the lessee to take delivery.

(b) If the goods are held by a bailee to be delivered without being moved, the risk of loss passes to the lessee on acknowledgment by the bailee of the lessee's right to possession of the goods.

(c) In any case not within subsection (a) or (b), the risk of loss passes to the lessee on the lessee's receipt of the goods if the lessor, or, in the case of a finance lease, the supplier, is a merchant; otherwise the risk passes to the lessee on tender of delivery.

2A-220. EFFECT OF DEFAULT ON RISK OF LOSS.

(1) Where risk of loss is to pass to the lessee and the time of passage is not stated:

(a) If a tender or delivery of goods so fails to conform to the lease contract as to give a right of rejection, the risk of their loss remains with the lessor, or, in the case of a finance lease, the supplier, until cure or acceptance.

(b) If the lessee rightfully revokes acceptance, he [or she], to the extent of any deficiency in his [or her] effective insurance coverage, may treat the risk of loss as having remained with the lessor from the beginning.

(2) Whether or not risk of loss is to pass to the lessee, if the lessee as to conforming goods already identified to a lease contract repudiates or is otherwise in default under the lease contract, the lessor, or, in the case of a finance lease, the supplier, to the extent of any deficiency in his [or her] effective insurance coverage may treat the risk of loss as resting on the lessee for a commercially reasonable time.

2A-221. CASUALTY TO IDENTIFIED GOODS.

If a lease contract requires goods identified when the lease contract is made, and the goods suffer casualty without fault of the lessee, the lessor or the supplier before delivery, or the goods suffer casualty before risk of loss passes to the lessee pursuant to the lease agreement or Section 2A-219, then:

(a) if the loss is total, the lease contract is avoided; and

(b) if the loss is partial or the goods have so deteriorated as to no longer conform to the lease contract, the lessee may nevertheless demand inspection and at his [or her] option either treat the lease contract as avoided or, except in a finance lease that is not a consumer lease, accept the goods with due allowance from the rent payable for the balance of the lease term for the deterioration or the deficiency in quantity but without further right against the lessor.

PART 3. EFFECT OF LEASE CONTRACT [Table of Contents]

2A-301. ENFORCEABILITY OF LEASE CONTRACT.

Except as otherwise provided in this Article, a lease contract is effective and enforceable according to its terms between the parties, against purchasers of the goods and against creditors of the parties.

2A-302. TITLE TO AND POSSESSION OF GOODS.

Except as otherwise provided in this Article, each provision of this Article applies whether the lessor or a third party has title to the goods, and whether the lessor, the lessee, or a third party has possession of the goods, notwithstanding any statute or rule of law that possession or the absence of possession is fraudulent.

2A-303. ALIENABILITY OF PARTY'S INTEREST UNDER LEASE CONTRACT OR OF LESSOR'S RESIDUAL INTEREST IN GOODS; DELEGATION OF PERFORMANCE; TRANSFER OF RIGHTS.

(1) As used in this section, "creation of a security interest" includes the sale of a lease contract that is subject to Article 9, Secured Transactions, by reason of Section 9-109(a)(3).

(2) Except as provided in subsection (3) and Section 9-407, a provision in a lease agreement which (i) prohibits the voluntary or involuntary transfer, including a transfer by sale, sublease, creation or enforcement of a security interest, or attachment, levy, or other judicial process, of an interest of a party under the lease contract or of the lessor's residual interest in the goods, or (ii) makes such a transfer an event of default, gives rise to the rights and remedies provided in subsection (4), but a transfer that is prohibited or is an event of default under the lease agreement is otherwise effective.

(3) A provision in a lease agreement which (i) prohibits a transfer of a right to damages for default with respect to the whole lease contract or of a right to payment arising out of the transferor's due performance of the transferor's entire obligation , or (ii) makes such a transfer an event of default, is not enforceable, and such a transfer is not a transfer that materially impairs the prospect of obtaining return performance by, materially changes the duty of, or materially increases the burden or risk imposed on, the other party to the lease contract within the purview of subsection (4).

(4) Subject to subsection (3) and Section 9-407:

(a) if a transfer is made which is made an event of default under a lease agreement, the party to the lease contract not making the transfer, unless that party waives the default or otherwise agrees, has the rights and remedies described in Section 2A-501(2);

(b) if paragraph (a) is not applicable and if a transfer is made that (i) is prohibited under a lease agreement or (ii) materially impairs the prospect of obtaining return performance by, materially changes the duty of, or materially increases the burden or risk imposed on, the other party to the lease contract, unless the party not making the transfer agrees at any time to the transfer in the lease contract or otherwise, then, except as limited by contract, (i) the transferor is liable to the party not making the transfer for damages caused by the transfer to the extent that the damages could not reasonably be prevented by the party not making the transfer and (ii) a court having jurisdiction may grant other appropriate relief, including cancellation of the lease contract or an injunction against the transfer.

(5) A transfer of "the lease" or of "all my rights under the lease", or a transfer in similar general terms, is a transfer of rights and, unless the language or the circumstances, as in a transfer for security, indicate the contrary, the transfer is a delegation of duties by the transferor to the transferee. Acceptance by the transferee constitutes a promise by the transferee to perform those duties. The promise is enforceable by either the transferor or the other party to the lease contract.

(6) Unless otherwise agreed by the lessor and the lessee, a delegation of performance does not relieve the transferor as against the other party of any duty to perform or of any liability for default.

(7) In a consumer lease, to prohibit the transfer of an interest of a party under the lease contract or to make a transfer an event of default, the language must be specific, by a writing, and conspicuous.

2A-304. SUBSEQUENT LEASE OF GOODS BY LESSOR.

(1) Subject to Section 2A-303, a subsequent lessee from a lessor of goods under an existing lease contract obtains, to the extent of the leasehold interest transferred, the leasehold interest in the goods that the lessor had or had power to transfer, and except as provided in subsection (2) and Section

2A-527(4), takes subject to the existing lease contract. A lessor with voidable title has power to transfer a good leasehold interest to a good faith subsequent lessee for value, but only to the extent set forth in the preceding sentence. If goods have been delivered under a transaction of purchase, the lessor has that power even though:

(a) the lessor's transferor was deceived as to the identity of the lessor;

(b) the delivery was in exchange for a check which is later dishonored;

(c) it was agreed that the transaction was to be a "cash sale"; or

(d) the delivery was procured through fraud punishable as larcenous under the criminal law.

(2) A subsequent lessee in the ordinary course of business from a lessor who is a merchant dealing in goods of that kind to whom the goods were entrusted by the existing lessee of that lessor before the interest of the subsequent lessee became enforceable against that lessor obtains, to the extent of the leasehold interest transferred, all of that lessor's and the existing lessee's rights to the goods, and takes free of the existing lease contract.

(3) A subsequent lessee from the lessor of goods that are subject to an existing lease contract and are covered by a certificate of title issued under a statute of this State or of another jurisdiction takes no greater rights than those provided both by this section and by the certificate of title statute.

2A-305. SALE OR SUBLEASE OF GOODS BY LESSEE.

(1) Subject to the provisions of Section 2A-303, a buyer or sublessee from the lessee of goods under an existing lease contract obtains, to the extent of the interest transferred, the leasehold interest in the goods that the lessee had or had power to transfer, and except as provided in subsection (2) and Section 2A-511(4), takes subject to the existing lease contract. A lessee with a voidable leasehold interest has power to transfer a good leasehold interest to a good faith buyer for value or a good faith sublessee for value, but only to the extent set forth in the preceding sentence. When goods have been delivered under a transaction of lease the lessee has that power even though:

(a) the lessor was deceived as to the identity of the lessee;

(b) the delivery was in exchange for a check which is later dishonored; or

(c) the delivery was procured through fraud punishable as larcenous under the criminal law.

(2) A buyer in the ordinary course of business or a sublessee in the ordinary course of business from a lessee who is a merchant dealing in goods of that kind to whom the goods were entrusted by the lessor obtains, to the extent of the interest transferred, all of the lessor's and lessee's rights to the goods, and takes free of the existing lease contract.

(3) A buyer or sublessee from the lessee of goods that are subject to an existing lease contract and are covered by a certificate of title issued under a statute of this State or of another jurisdiction takes no greater rights than those provided both by this section and by the certificate of title statute.

2A-306. PRIORITY OF CERTAIN LIENS ARISING BY OPERATION OF LAW.

If a person in the ordinary course of his [or her] business furnishes services or materials with respect to goods subject to a lease contract, a lien upon those goods in the possession of that person given by statute or rule of law for those materials or services takes priority over any interest of the lessor or lessee under the lease contract or this Article unless the lien is created by statute and the statute provides otherwise or unless the lien is created by rule of law and the rule of law provides otherwise.

2A-307. PRIORITY OF LIENS ARISING BY ATTACHMENT OR LEVY ON, SECURITY INTERESTS IN, AND OTHER CLAIMS TO GOODS.

(1) Except as otherwise provided in Section 2A-306, a creditor of a lessee takes subject to the lease contract.

(2) Except as otherwise provided in subsection (3) and in Sections 2A-306 and 2A-308, a creditor of a lessor takes subject to the lease contract unless the creditor holds a lien that attached to the goods before the lease contract became enforceable.

(3) Except as otherwise provided in Sections 9-317, 9-321, and 9-323, a lessee takes a leasehold interest subject to a security interest held by a creditor of the lessor.

2A-308. SPECIAL RIGHTS OF CREDITORS.

(1) A creditor of a lessor in possession of goods subject to a lease contract may treat the lease contract as void if as against the creditor retention of possession by the lessor is fraudulent under any statute or rule of law, but retention of possession in good faith and current course of trade by the

lessor for a commercially reasonable time after the lease contract becomes enforceable is not fraudulent.

(2) Nothing in this Article impairs the rights of creditors of a lessor if the lease contract (a) becomes enforceable, not in current course of trade but in satisfaction of or as security for a pre-existing claim for money, security, or the like, and (b) is made under circumstances which under any statute or rule of law apart from this Article would constitute the transaction a fraudulent transfer or voidable preference.

(3) A creditor of a seller may treat a sale or an identification of goods to a contract for sale as void if as against the creditor retention of possession by the seller is fraudulent under any statute or rule of law, but retention of possession of the goods pursuant to a lease contract entered into by the seller as lessee and the buyer as lessor in connection with the sale or identification of the goods is not fraudulent if the buyer bought for value and in good faith.

2A-309. LESSOR'S AND LESSEE'S RIGHTS WHEN GOODS BECOME FIXTURES.

(1) In this section:

(a) goods are "fixtures" when they become so related to particular real estate that an interest in them arises under real estate law;

(b) a "fixture filing" is the filing, in the office where a mortgage on the real estate would be filed or recorded , of a financing statement covering goods that are or are to become fixtures and conforming to the requirements of Section 9-502(a) and (b);

(c) a lease is a "purchase money lease" unless the lessee has possession or use of the goods or the right to possession or use of the goods before the lease agreement is enforceable;

(d) a mortgage is a "construction mortgage" to the extent it secures an obligation incurred for the construction of an improvement on land including the acquisition cost of the land, if the recorded writing so indicates; and

(e) "encumbrance" includes real estate mortgages and other liens on real estate and all other rights in real estate that are not ownership interests.

(2) Under this Article a lease may be of goods that are fixtures or may continue in goods that become fixtures, but no lease exists under this Article of ordinary building materials incorporated into an improvement on land.

(3) This Article does not prevent creation of a lease of fixtures pursuant to real estate law.

(4) The perfected interest of a lessor of fixtures has priority over a conflicting interest of an encumbrancer or owner of the real estate if:

(a) the lease is a purchase money lease, the conflicting interest of the encumbrancer or owner arises before the goods become fixtures, the interest of the lessor is perfected by a fixture filing before the goods become fixtures or within ten days thereafter, and the lessee has an interest of record in the real estate or is in possession of the real estate; or

(b) the interest of the lessor is perfected by a fixture filing before the interest of the encumbrancer or owner is of record, the lessor's interest has priority over any conflicting interest of a predecessor in title of the encumbrancer or owner, and the lessee has an interest of record in the real estate or is in possession of the real estate.

(5) The interest of a lessor of fixtures, whether or not perfected, has priority over the conflicting interest of an encumbrancer or owner of the real estate if:

(a) the fixtures are readily removable factory or office machines, readily removable equipment that is not primarily used or leased for use in the operation of the real estate, or readily removable replacements of domestic appliances that are goods subject to a consumer lease, and before the goods become fixtures the lease contract is enforceable; or

(b) the conflicting interest is a lien on the real estate obtained by legal or equitable proceedings after the lease contract is enforceable; or

(c) the encumbrancer or owner has consented in writing to the lease or has disclaimed an interest in the goods as fixtures; or

(d) the lessee has a right to remove the goods as against the encumbrancer or owner. If the lessee's right to remove terminates, the priority of the interest of the lessor continues for a reasonable time.

(6) Notwithstanding subsection (4)(a) but otherwise subject to subsections (4) and (5), the interest of a lessor of fixtures, including the lessor's residual interest, is subordinate to the conflicting interest of an encumbrancer of the real estate under a construction mortgage recorded before the goods become fixtures if the goods become fixtures before the completion of the construction. To the extent given to refinance a construction mortgage, the conflicting interest of an encumbrancer of the real estate under a mortgage has this priority to the same extent as the encumbrancer of the real estate under the construction mortgage.

(7) In cases not within the preceding subsections, priority between the interest of a lessor of fixtures, including the lessor's residual interest, and the conflicting interest of an encumbrancer or owner of the real estate who is not the lessee is determined by the priority rules governing conflicting interests in real estate.

(8) If the interest of a lessor of fixtures, including the lessor's residual interest, has priority over all conflicting interests of all owners and encumbrancers of the real estate, the lessor or the lessee may (i) on default, expiration, termination, or cancellation of the lease agreement but subject to the lease agreement and this Article, or (ii) if necessary to enforce other rights and remedies of the lessor or lessee under this Article, remove the goods from the real estate, free and clear of all conflicting interests of all owners and encumbrancers of the real estate.

The lessor or lessee must reimburse any encumbrancer or owner of the real estate who is not the lessee and who has not otherwise agreed for the cost of repair of any physical injury, but not for any diminution in value of the real estate caused by the absence of the goods removed or by any necessity of replacing them. A person entitled to reimbursement may refuse permission to remove until the party seeking removal gives adequate security for the performance of this obligation.

(9) Even though the lease agreement does not create a security interest, the interest of a lessor of fixtures, including the lessor's residual interest, is perfected by filing a financing statement as a fixture filing for leased goods that are or are to become fixtures in accordance with the relevant provisions of the Article on Secured Transactions (Article 9).

2A-310. LESSOR'S AND LESSEE'S RIGHTS WHEN GOODS BECOME ACCESSIONS.

(1) Goods are "accessions" when they are installed in or affixed to other goods.

(2) The interest of a lessor or a lessee under a lease contract entered into before the goods became accessions is superior to all interests in the whole except as stated in subsection (4).

(3) The interest of a lessor or a lessee under a lease contract entered into at the time or after the goods became accessions is superior to all subsequently acquired interests in the whole except as stated in subsection (4) but is subordinate to interests in the whole existing at the time the lease contract was made unless the holders of such interests in the whole have in writing consented to the lease or disclaimed an interest in the goods as part of the whole.

(4) The interest of a lessor or a lessee under a lease contract described in subsection (2) or (3) is subordinate to the interest of

(a) a buyer in the ordinary course of business or a lessee in the ordinary course of business of any interest in the whole acquired after the goods became accessions; or

(b) a creditor with a security interest in the whole perfected before the lease contract was made to the extent that the creditor makes subsequent advances without knowledge of the lease contract.

(5) When under subsections (2) or (3) and (4) a lessor or a lessee of accessions holds an interest that is superior to all interests in the whole, the lessor or the lessee may (a) on default, expiration, termination, or cancellation of the lease contract by the other party but subject to the provisions of the lease contract and this Article, or (b) if necessary to enforce his [or her] other rights and remedies under this Article, remove the goods from the whole, free and clear of all interests in the whole, but he [or she] must reimburse any holder of an interest in the whole who is not the lessee and who has not otherwise agreed for the cost of repair of any physical injury but not for any diminution in value of the whole caused by the absence of the goods removed or by any necessity for replacing them. A person entitled to reimbursement may refuse permission to remove until the party seeking removal gives adequate security for the performance of this obligation.

2A-311. PRIORITY SUBJECT TO SUBORDINATION.

Nothing in this Article prevents subordination by agreement by any person entitled to priority.

PART 4. PERFORMANCE OF LEASE CONTRACT: REPUDIATED, SUBSTITUTED AND EXCUSED
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2A-401. INSECURITY: ADEQUATE ASSURANCE OF PERFORMANCE.

(1) A lease contract imposes an obligation on each party that the other's expectation of receiving due performance will not be impaired.

(2) If reasonable grounds for insecurity arise with respect to the performance of either party, the insecure party may demand in writing adequate assurance of due performance. Until the insecure party receives that assurance, if commercially reasonable the insecure party may suspend any performance for which he [or she] has not already received the agreed return.

(3) A repudiation of the lease contract occurs if assurance of due performance adequate under the circumstances of the particular case is not provided to the insecure party within a reasonable time, not to exceed 30 days after receipt of a demand by the other party.

(4) Between merchants, the reasonableness of grounds for insecurity and the adequacy of any assurance offered must be determined according to commercial standards.

(5) Acceptance of any nonconforming delivery or payment does not prejudice the aggrieved party's right to demand adequate assurance of future performance.

2A-402. ANTICIPATORY REPUDIATION.

If either party repudiates a lease contract with respect to a performance not yet due under the lease contract, the loss of which performance will substantially impair the value of the lease contract to the other, the aggrieved party may:

(a) for a commercially reasonable time, await retraction of repudiation and performance by the repudiating party;

(b) make demand pursuant to Section 2A-401 and await assurance of future performance adequate under the circumstances of the particular case; or

(c) resort to any right or remedy upon default under the lease contract or this Article, even though the aggrieved party has notified the repudiating party that the aggrieved party would await the repudiating party's performance and assurance and has urged retraction. In addition, whether or not the aggrieved party is pursuing one of the foregoing remedies, the aggrieved party may suspend performance or, if the aggrieved party is the lessor, proceed in accordance with the provisions of this Article on the lessor's right to identify goods to the lease contract notwithstanding default or to salvage unfinished goods (Section 2A-524).

2A-403. RETRACTION OF ANTICIPATORY REPUDIATION.

(1) Until the repudiating party's next performance is due, the repudiating party can retract the repudiation unless, since the repudiation, the aggrieved party has cancelled the lease contract or materially changed the aggrieved party's position or otherwise indicated that the aggrieved party considers the repudiation final.

(2) Retraction may be by any method that clearly indicates to the aggrieved party that the repudiating party intends to perform under the lease contract and includes any assurance demanded under Section 2A-401.

(3) Retraction reinstates a repudiating party's rights under a lease contract with due excuse and allowance to the aggrieved party for any delay occasioned by the repudiation.

2A-404. SUBSTITUTED PERFORMANCE.

(1) If without fault of the lessee, the lessor and the supplier, the agreed berthing, loading, or unloading facilities fail or the agreed type of carrier becomes unavailable or the agreed manner of delivery otherwise becomes commercially impracticable, but a commercially reasonable substitute is available, the substitute performance must be tendered and accepted.

(2) If the agreed means or manner of payment fails because of domestic or foreign governmental regulation:

(a) the lessor may withhold or stop delivery or cause the supplier to withhold or stop delivery unless the lessee provides a means or manner of payment that is commercially a substantial equivalent; and

(b) if delivery has already been taken, payment by the means or in the manner provided by the regulation discharges the lessee's obligation unless the regulation is discriminatory, oppressive, or predatory.

2A-405. EXCUSED PERFORMANCE.

Subject to Section 2A-404 on substituted performance, the following rules apply:

(a) Delay in delivery or nondelivery in whole or in part by a lessor or a supplier who complies with paragraphs (b) and (c) is not a default under the lease contract if performance as agreed has been made impracticable by the occurrence of a contingency the nonoccurrence of which was a basic assumption on which the lease contract was made or by compliance in good faith with any applicable foreign or domestic governmental regulation or order, whether or not the regulation or order later proves to be invalid.

(b) If the causes mentioned in paragraph (a) affect only part of the lessor's or the supplier's capacity to perform, he [or she] shall allocate production and deliveries among his [or her] customers but at his [or her] option may include regular customers not then under contract for sale or lease as well as his [or her] own requirements for further manufacture. He [or she] may so allocate in any manner that is fair and reasonable.

(c) The lessor seasonably shall notify the lessee and in the case of a finance lease the supplier seasonably shall notify the lessor and the lessee, if known, that there will be delay or nondelivery and, if allocation is required under paragraph (b), of the estimated quota thus made available for the lessee.

2A-406. PROCEDURE ON EXCUSED PERFORMANCE.

(1) If the lessee receives notification of a material or indefinite delay or an allocation justified under Section 2A-405, the lessee may by written notification to the lessor as to any goods involved, and with respect to all of the goods if under an installment lease contract the value of the whole lease contract is substantially impaired (Section 2A-510):

(a) terminate the lease contract (Section 2A-505(2)); or

(b) except in a finance lease that is not a consumer lease, modify the lease contract by accepting the available quota in substitution, with due allowance from the rent payable for the balance of the lease term for the deficiency but without further right against the lessor.

(2) If, after receipt of a notification from the lessor under Section 2A-405, the lessee fails so to modify the lease agreement within a reasonable time not exceeding 30 days, the lease contract lapses with respect to any deliveries affected.

2A-407. IRREVOCABLE PROMISES: FINANCE LEASES.

(1) In the case of a finance lease that is not a consumer lease the lessee's promises under the lease contract become irrevocable and independent upon the lessee's acceptance of the goods.

(2) A promise that has become irrevocable and independent under subsection (1):

(a) is effective and enforceable between the parties, and by or against third parties including assignees of the parties ; and

(b) is not subject to cancellation, termination, modification, repudiation, excuse, or substitution without the consent of the party to whom the promise runs.

(3) This section does not affect the validity under any other law of a covenant in any lease contract making the lessee's promises irrevocable and independent upon the lessee's acceptance of the goods.

PART 5. DEFAULT [Table of Contents]

A. IN GENERAL [Table of Contents]

2A-501. DEFAULT: PROCEDURE.

(1) Whether the lessor or the lessee is in default under a lease contract is determined by the lease agreement and this Article.

(2) If the lessor or the lessee is in default under the lease contract, the party seeking enforcement has rights and remedies as provided in this Article and, except as limited by this Article, as provided in the lease agreement.

(3) If the lessor or the lessee is in default under the lease contract, the party seeking enforcement may reduce the party's claim to judgment, or otherwise enforce the lease contract by self-help or any available judicial procedure or nonjudicial procedure, including administrative proceeding, arbitration, or the like, in accordance with this Article.

(4) Except as otherwise provided in Section 1-106(1) or this Article or the lease agreement, the rights and remedies referred to in subsections (2) and (3) are cumulative.

(5) If the lease agreement covers both real property and goods, the party seeking enforcement may proceed under this Part as to the goods, or under other applicable law as to both the real property

and the goods in accordance with that party's rights and remedies in respect of the real property, in which case this Part does not apply.

2A-502. NOTICE AFTER DEFAULT.

Except as otherwise provided in this Article or the lease agreement, the lessor or lessee in default under the lease contract is not entitled to notice of default or notice of enforcement from the other party to the lease agreement.

2A-503. MODIFICATION OR IMPAIRMENT OF RIGHTS AND REMEDIES.

(1) Except as otherwise provided in this Article, the lease agreement may include rights and remedies for default in addition to or in substitution for those provided in this Article and may limit or alter the measure of damages recoverable under this Article.

(2) Resort to a remedy provided under this Article or in the lease agreement is optional unless the remedy is expressly agreed to be exclusive. If circumstances cause an exclusive or limited remedy to fail of its essential purpose, or provision for an exclusive remedy is unconscionable, remedy may be had as provided in this Article.

(3) Consequential damages may be liquidated under Section 2A-504, or may otherwise be limited, altered, or excluded unless the limitation, alteration, or exclusion is unconscionable. Limitation, alteration, or exclusion of consequential damages for injury to the person in the case of consumer goods is prima facie unconscionable but limitation, alteration, or exclusion of damages where the loss is commercial is not prima facie unconscionable.

(4) Rights and remedies on default by the lessor or the lessee with respect to any obligation or promise collateral or ancillary to the lease contract are not impaired by this Article.

2A-504. LIQUIDATION OF DAMAGES.

(1) Damages payable by either party for default, or any other act or omission, including indemnity for loss or diminution of anticipated tax benefits or loss or damage to lessor's residual interest, may be liquidated in the lease agreement but only at an amount or by a formula that is reasonable in light of the then anticipated harm caused by the default or other act or omission.

(2) If the lease agreement provides for liquidation of damages, and such provision does not comply with subsection (1), or such provision is an exclusive or limited remedy that circumstances cause to fail of its essential purpose, remedy may be had as provided in this Article.

(3) If the lessor justifiably withholds or stops delivery of goods because of the lessee's default or insolvency (Section 2A-525 or 2A-526), the lessee is entitled to restitution of any amount by which the sum of his [or her] payments exceeds:

(a) the amount to which the lessor is entitled by virtue of terms liquidating the lessor's damages in accordance with subsection (1); or

(b) in the absence of those terms, 20 percent of the then present value of the total rent the lessee was obligated to pay for the balance of the lease term, or, in the case of a consumer lease, the lesser of such amount or $500.

(4) A lessee's right to restitution under subsection (3) is subject to offset to the extent the lessor establishes:

(a) a right to recover damages under the provisions of this Article other than subsection (1); and

(b) the amount or value of any benefits received by the lessee directly or indirectly by reason of the lease contract.

2A-505. CANCELLATION AND TERMINATION AND EFFECT OF CANCELLATION, TERMINATION, RESCISSION, OR FRAUD ON RIGHTS AND REMEDIES.

(1) On cancellation of the lease contract, all obligations that are still executory on both sides are discharged, but any right based on prior default or performance survives, and the cancelling party also retains any remedy for default of the whole lease contract or any unperformed balance.

(2) On termination of the lease contract, all obligations that are still executory on both sides are discharged but any right based on prior default or performance survives.

(3) Unless the contrary intention clearly appears, expressions of "cancellation,""rescission," or the like of the lease contract may not be construed as a renunciation or discharge of any claim in damages for an antecedent default.

(4) Rights and remedies for material misrepresentation or fraud include all rights and remedies available under this Article for default.

(5) Neither rescission nor a claim for rescission of the lease contract nor rejection or return of the goods may bar or be deemed inconsistent with a claim for damages or other right or remedy.

2A-506. STATUTE OF LIMITATIONS.

(1) An action for default under a lease contract, including breach of warranty or indemnity, must be commenced within 4 years after the cause of action accrued. By the original lease contract the parties may reduce the period of limitation to not less than one year.

(2) A cause of action for default accrues when the act or omission on which the default or breach of warranty is based is or should have been discovered by the aggrieved party, or when the default occurs, whichever is later. A cause of action for indemnity accrues when the act or omission on which the claim for indemnity is based is or should have been discovered by the indemnified party, whichever is later.

(3) If an action commenced within the time limited by subsection (1) is so terminated as to leave available a remedy by another action for the same default or breach of warranty or indemnity, the other action may be commenced after the expiration of the time limited and within 6 months after the termination of the first action unless the termination resulted from voluntary discontinuance or from dismissal for failure or neglect to prosecute.

(4) This section does not alter the law on tolling of the statute of limitations nor does it apply to causes of action that have accrued before this Article becomes effective.

2A-507. PROOF OF MARKET RENT: TIME AND PLACE.

(1) Damages based on market rent (Section 2A-519 or 2A-528) are determined according to the rent for the use of the goods concerned for a lease term identical to the remaining lease term of the original lease agreement and prevailing at the times specified in Sections 2A-519 and 2A-528.

(2) If evidence of rent for the use of the goods concerned for a lease term identical to the remaining lease term of the original lease agreement and prevailing at the times or places described in this Article is not readily available, the rent prevailing within any reasonable time before or after the time described or at any other place or for a different lease term which in commercial judgment or under usage of trade would serve as a reasonable substitute for the one described may be used, making any proper allowance for the difference, including the cost of transporting the goods to or from the other place.

(3) Evidence of a relevant rent prevailing at a time or place or for a lease term other than the one described in this Article offered by one party is not admissible unless and until he [or she] has given the other party notice the court finds sufficient to prevent unfair surprise.

(4) If the prevailing rent or value of any goods regularly leased in any established market is in issue, reports in official publications or trade journals or in newspapers or periodicals of general circulation published as the reports of that market are admissible in evidence. The circumstances of the preparation of the report may be shown to affect its weight but not its admissibility.

B. DEFAULT BY LESSOR [Table of Contents]

2A-508. LESSEE'S REMEDIES.

(1) If a lessor fails to deliver the goods in conformity to the lease contract (Section 2A-509) or repudiates the lease contract (Section 2A-402), or a lessee rightfully rejects the goods (Section 2A-509) or justifiably revokes acceptance of the goods (Section 2A-517), then with respect to any goods involved, and with respect to all of the goods if under an installment lease contract the value of the whole lease contract is substantially impaired (Section 2A-510), the lessor is in default under the lease contract and the lessee may:

(a) cancel the lease contract (Section 2A-505(1));

(b) recover so much of the rent and security as has been paid and is just under the circumstances;

(c) cover and recover damages as to all goods affected whether or not they have been identified to the lease contract (Sections 2A-518 and 2A-520), or recover damages for nondelivery (Sections 2A-519 and 2A-520);

(d) exercise any other rights or pursue any other remedies provided in the lease contract.

(2) If a lessor fails to deliver the goods in conformity to the lease contract or repudiates the lease contract, the lessee may also:

(a) if the goods have been identified, recover them (Section 2A-522); or

(b) in a proper case, obtain specific performance or replevy the goods (Section 2A-521).

(3) If a lessor is otherwise in default under a lease contract, the lessee may exercise the rights and pursue the remedies provided in the lease contract, which may include a right to cancel the lease, and in Section 2A-519(3).

(4) If a lessor has breached a warranty, whether express or implied, the lessee may recover damages (Section 2A-519(4)).

(5) On rightful rejection or justifiable revocation of acceptance, a lessee has a security interest in goods in the lessee's possession or control for any rent and security that has been paid and any expenses reasonably incurred in their inspection, receipt, transportation, and care and custody and may hold those goods and dispose of them in good faith and in a commercially reasonable manner, subject to Section 2A-527(5).

(6) Subject to the provisions of Section 2A-407, a lessee, on notifying the lessor of the lessee's intention to do so, may deduct all or any part of the damages resulting from any default under the lease contract from any part of the rent still due under the same lease contract.

2A-509. LESSEE'S RIGHTS ON IMPROPER DELIVERY; RIGHTFUL REJECTION.

(1) Subject to the provisions of Section 2A-510 on default in installment lease contracts, if the goods or the tender or delivery fail in any respect to conform to the lease contract, the lessee may reject or accept the goods or accept any commercial unit or units and reject the rest of the goods.

(2) Rejection of goods is ineffective unless it is within a reasonable time after tender or delivery of the goods and the lessee seasonably notifies the lessor.

2A-510. INSTALLMENT LEASE CONTRACTS: REJECTION AND DEFAULT.

(1) Under an installment lease contract a lessee may reject any delivery that is nonconforming if the nonconformity substantially impairs the value of that delivery and cannot be cured or the nonconformity is a defect in the required documents; but if the nonconformity does not fall within subsection (2) and the lessor or the supplier gives adequate assurance of its cure, the lessee must accept that delivery.

(2) Whenever nonconformity or default with respect to one or more deliveries substantially impairs the value of the installment lease contract as a whole there is a default with respect to the whole. But, the aggrieved party reinstates the installment lease contract as a whole if the aggrieved party accepts a nonconforming delivery without seasonably notifying of cancellation or brings an action with respect only to past deliveries or demands performance as to future deliveries.

2A-511. MERCHANT LESSEE'S DUTIES AS TO RIGHTFULLY REJECTED GOODS.

(1) Subject to any security interest of a lessee (Section 2A-508(5)), if a lessor or a supplier has no agent or place of business at the market of rejection, a merchant lessee, after rejection of goods in his [or her] possession or control, shall follow any reasonable instructions received from the lessor or the supplier with respect to the goods. In the absence of those instructions, a merchant lessee shall make reasonable efforts to sell, lease, or otherwise dispose of the goods for the lessor's account if they threaten to decline in value speedily. Instructions are not reasonable if on demand indemnity for expenses is not forthcoming.

(2) If a merchant lessee (subsection (1)) or any other lessee (Section 2A-512) disposes of goods, he [or she] is entitled to reimbursement either from the lessor or the supplier or out of the proceeds for reasonable expenses of caring for and disposing of the goods and, if the expenses include no disposition commission, to such commission as is usual in the trade, or if there is none, to a reasonable sum not exceeding 10 percent of the gross proceeds.

(3) In complying with this section or Section 2A-512, the lessee is held only to good faith. Good faith conduct hereunder is neither acceptance or conversion nor the basis of an action for damages.

(4) A purchaser who purchases in good faith from a lessee pursuant to this section or Section 2A-512 takes the goods free of any rights of the lessor and the supplier even though the lessee fails to comply with one or more of the requirements of this Article.

2A-512. LESSEE'S DUTIES AS TO RIGHTFULLY REJECTED GOODS.

(1) Except as otherwise provided with respect to goods that threaten to decline in value speedily (Section 2A-511) and subject to any security interest of a lessee (Section 2A-508(5)):

(a) the lessee, after rejection of goods in the lessee's possession, shall hold them with reasonable care at the lessor's or the supplier's disposition for a reasonable time after the lessee's seasonable notification of rejection;

(b) if the lessor or the supplier gives no instructions within a reasonable time after notification of rejection, the lessee may store the rejected goods for the lessor's or the supplier's account or ship them to the lessor or the supplier or dispose of them for the lessor's or the supplier's account with reimbursement in the manner provided in Section 2A-511; but

(c) the lessee has no further obligations with regard to goods rightfully rejected.

(2) Action by the lessee pursuant to subsection (1) is not acceptance or conversion.

2A-513. CURE BY LESSOR OF IMPROPER TENDER OR DELIVERY; REPLACEMENT.

(1) If any tender or delivery by the lessor or the supplier is rejected because nonconforming and the time for performance has not yet expired, the lessor or the supplier may seasonably notify the lessee of the lessor's or the supplier's intention to cure and may then make a conforming delivery within the time provided in the lease contract.

(2) If the lessee rejects a nonconforming tender that the lessor or the supplier had reasonable grounds to believe would be acceptable with or without money allowance, the lessor or the supplier may have a further reasonable time to substitute a conforming tender if he [or she] seasonably notifies the lessee.

2A-514. WAIVER OF LESSEE'S OBJECTIONS.

(1) In rejecting goods, a lessee's failure to state a particular defect that is ascertainable by reasonable inspection precludes the lessee from relying on the defect to justify rejection or to establish default:

(a) if, stated seasonably, the lessor or the supplier could have cured it (Section 2A-513); or

(b) between merchants if the lessor or the supplier after rejection has made a request in writing for a full and final written statement of all defects on which the lessee proposes to rely.

(2) A lessee's failure to reserve rights when paying rent or other consideration against documents precludes recovery of the payment for defects apparent in the documents.

2A-515. ACCEPTANCE OF GOODS.

(1) Acceptance of goods occurs after the lessee has had a reasonable opportunity to inspect the goods and

(a) the lessee signifies or acts with respect to the goods in a manner that signifies to the lessor or the supplier that the goods are conforming or that the lessee will take or retain them in spite of their nonconformity; or

(b) the lessee fails to make an effective rejection of the goods (Section 2A-509(2)).

(2) Acceptance of a part of any commercial unit is acceptance of that entire unit.

2A-516. EFFECT OF ACCEPTANCE OF GOODS; NOTICE OF DEFAULT; BURDEN OF ESTABLISHING DEFAULT AFTER ACCEPTANCE; NOTICE OF CLAIM OR LITIGATION TO PERSON ANSWERABLE OVER.

(1) A lessee must pay rent for any goods accepted in accordance with the lease contract, with due allowance for goods rightfully rejected or not delivered.

(2) A lessee's acceptance of goods precludes rejection of the goods accepted. In the case of a finance lease, if made with knowledge of a nonconformity, acceptance cannot be revoked because of it. In any other case, if made with knowledge of a nonconformity, acceptance cannot be revoked because of it unless the acceptance was on the reasonable assumption that the nonconformity would be seasonably cured. Acceptance does not of itself impair any other remedy provided by this Article or the lease agreement for nonconformity.

(3) If a tender has been accepted:

(a) within a reasonable time after the lessee discovers or should have discovered any default, the lessee shall notify the lessor and the supplier, if any, or be barred from any remedy against the party not notified;

(b) except in the case of a consumer lease, within a reasonable time after the lessee receives notice of litigation for infringement or the like (Section 2A-211) the lessee shall notify the lessor or be barred from any remedy over for liability established by the litigation; and

(c) the burden is on the lessee to establish any default.

(4) If a lessee is sued for breach of a warranty or other obligation for which a lessor or a supplier is answerable over the following apply:

(a) The lessee may give the lessor or the supplier, or both, written notice of the litigation. If the notice states that the person notified may come in and defend and that if the person notified does not do so that person will be bound in any action against that person by the lessee by any determination of fact common to the two litigations, then unless the person notified after seasonable receipt of the notice does come in and defend that person is so bound.

(b) The lessor or the supplier may demand in writing that the lessee turn over control of the litigation including settlement if the claim is one for infringement or the like (Section 2A-211) or else be barred from any remedy over. If the demand states that the lessor or the supplier agrees to bear all expense and to satisfy any adverse judgment, then unless the lessee after seasonable receipt of the demand does turn over control the lessee is so barred.

(5) Subsections (3) and (4) apply to any obligation of a lessee to hold the lessor or the supplier harmless against infringement or the like (Section 2A-211).

2A-517. REVOCATION OF ACCEPTANCE OF GOODS.

(1) A lessee may revoke acceptance of a lot or commercial unit whose nonconformity substantially impairs its value to the lessee if the lessee has accepted it:

(a) except in the case of a finance lease, on the reasonable assumption that its nonconformity would be cured and it has not been seasonably cured; or

(b) without discovery of the nonconformity if the lessee's acceptance was reasonably induced either by the lessor's assurances or, except in the case of a finance lease, by the difficulty of discovery before acceptance.

(2) Except in the case of a finance lease that is not a consumer lease, a lessee may revoke acceptance of a lot or commercial unit if the lessor defaults under the lease contract and the default substantially impairs the value of that lot or commercial unit to the lessee.

(3) If the lease agreement so provides, the lessee may revoke acceptance of a lot or commercial unit because of other defaults by the lessor.

(4) Revocation of acceptance must occur within a reasonable time after the lessee discovers or should have discovered the ground for it and before any substantial change in condition of the goods which is not caused by the nonconformity. Revocation is not effective until the lessee notifies the lessor of the present value as of the same date of the total rent for the then remaining lease term of the original lease agreement, and (ii) any incidental or consequential damages, less expenses saved in consequence of the lessor's default.

2A-518. COVER; SUBSTITUTE GOODS.

(1) After a default by a lessor under the lease contract of the type described in Section 2A-508(1), or, if agreed, after other default by the lessor, the lessee may cover by making any purchase or lease of or contract to purchase or lease goods in substitution for those due from the lessor.

(2) Except as otherwise provided with respect to damages liquidated in the lease agreement (Section 2A-504) or otherwise determined pursuant to agreement of the parties (Sections 1-302 and 2A-503), if a lessee's cover is by a lease agreement substantially similar to the original lease agreement and the new lease agreement is made in good faith and in a commercially reasonable manner, the lessee may recover from the lessor as damages (i) the present value, as of the date of the commencement of the term of the new lease agreement, of the rent under the new lease agreement applicable to that period of the new lease term which is comparable to the then remaining term of the original lease agreement minus the present value as of the same date of the total rent for the then remaining lease term of the original lease agreement, and (ii) any incidental or consequential damages, less expenses saved in consequence of the lessor's default.

(3) If a lessee's cover is by lease agreement that for any reason does not qualify for treatment under subsection (2), or is by purchase or otherwise, the lessee may recover from the lessor as if the lessee had elected not to cover and Section 2A-519 governs.

2A-519. LESSEE'S DAMAGES FOR NON-DELIVERY, REPUDIATION, DEFAULT, AND BREACH OF WARRANTY IN REGARD TO ACCEPTED GOODS.

(1) Except as otherwise provided with respect to damages liquidated in the lease agreement (Section 2A-504) or otherwise determined pursuant to agreement of the parties (Sections 1-302 and 2A-503), if a lessee elects not to cover or a lessee elects to cover and the cover is by lease agreement that for any reason does not qualify for treatment under Section 2A-518(2), or is by purchase or otherwise, the measure of damages for non-delivery or repudiation by the lessor or for rejection or revocation of acceptance by the lessee is the present value, as of the date of the default, of the then market rent minus the present value as of the same date of the original rent, computed for the remaining lease

term of the original lease agreement, together with incidental and consequential damages, less expenses saved in consequence of the lessor's default.

(2) Market rent is to be determined as of the place for tender or, in cases of rejection after arrival or revocation of acceptance, as of the place of arrival.

(3) Except as otherwise agreed, if the lessee has accepted goods and given notification (Section 2A-516(3)), the measure of damages for non-conforming tender or delivery or other default by a lessor is the loss resulting in the ordinary course of events from the lessor's default as determined in any manner that is reasonable together with incidental and consequential damages, less expenses saved in consequence of the lessor's default.

(4) Except as otherwise agreed, the measure of damages for breach of warranty is the present value at the time and place of acceptance of the difference between the value of the use of the goods accepted and the value if they had been as warranted for the lease term, unless special circumstances show proximate damages of a different amount, together with incidental and consequential damages, less expenses saved in consequence of the lessor's default or breach of warranty.

2A-520. LESSEE'S INCIDENTAL AND CONSEQUENTIAL DAMAGES.

(1) Incidental damages resulting from a lessor's default include expenses reasonably incurred in inspection, receipt, transportation, and care and custody of goods rightfully rejected or goods the acceptance of which is justifiably revoked, any commercially reasonable charges, expenses or commissions in connection with effecting cover, and any other reasonable expense incident to the default.

(2) Consequential damages resulting from a lessor's default include:

(a) any loss resulting from general or particular requirements and needs of which the lessor at the time of contracting had reason to know and which could not reasonably be prevented by cover or otherwise; and

(b) injury to person or property proximately resulting from any breach of warranty.

2A-521. LESSEE'S RIGHT TO SPECIFIC PERFORMANCE OR REPLEVIN.

(1) Specific performance may be decreed if the goods are unique or in other proper circumstances. (2)

A decree for specific performance may include any terms and conditions as to payment of the rent, damages, or other relief that the court deems just.

(3) A lessee has a right of replevin, detinue, sequestration, claim and delivery, or the like for goods identified to the lease contract if after reasonable effort the lessee is unable to effect cover for those goods or the circumstances reasonably indicate that the effort will be unavailing.

2A-522. LESSEE'S RIGHT TO GOODS ON LESSOR'S INSOLVENCY.

(1) Subject to subsection (2) and even though the goods have not been shipped, a lessee who has paid a part or all of the rent and security for goods identified to a lease contract (Section 2A-217) on making and keeping good a tender of any unpaid portion of the rent and security due under the lease contract may recover the goods identified from the lessor if the lessor becomes insolvent within 10 days after receipt of the first installment of rent and security.

(2) A lessee acquires the right to recover goods identified to a lease contract only if they conform to the lease contract.

C. DEFAULT BY LESSEE [Table of Contents]

2A-523. LESSOR'S REMEDIES.

(1) If a lessee wrongfully rejects or revokes acceptance of goods or fails to make a payment when due or repudiates with respect to a part or the whole, then, with respect to any goods involved, and with respect to all of the goods if under an installment lease contract the value of the whole lease contract is substantially impaired (Section 2A-510), the lessee is in default under the lease contract and the lessor may:

(a) cancel the lease contract (Section 2A-505(1));

(b) proceed respecting goods not identified to the lease contract (Section 2A-524);

(c) withhold delivery of the goods and take possession of goods previously delivered (Section 2A-525);

(d) stop delivery of the goods by any bailee (Section 2A-526);

(e) dispose of the goods and recover damages (Section 2A-527), or retain the goods and recover damages (Section 2A-528), or in a proper case recover rent (Section 2A-529);

(f) exercise any other rights or pursue any other remedies provided in the lease contract.

(2) If a lessor does not fully exercise a right or obtain a remedy to which the lessor is entitled under subsection (1), the lessor may recover the loss resulting in the ordinary course of events from the lessee's default as determined in any reasonable manner, together with incidental damages, less expenses saved in consequence of the lessee's default.

(3) If a lessee is otherwise in default under a lease contract, the lessor may exercise the rights and pursue the remedies provided in the lease contract , which may include a right to cancel the lease. In addition, unless otherwise provided in the lease contract:

(a) if the default substantially impairs the value of the lease contract to the lessor, the lessor may exercise the rights and pursue the remedies provided in subsections (1) or (2); or

(b) if the default does not substantially impair the value of the lease contract to the lessor, the lessor may recover as provided in subsection (2).

2A-524. LESSOR'S RIGHT TO IDENTIFY GOODS TO LEASE CONTRACT.

(1) After default by the lessee under the lease contract of the type described in Section 2A-523(1) or Section 2A-523(3)(a) or, if agreed, after other default by the lessee, the lessor may:

(a) identify to the lease contract conforming goods not already identified if at the time the lessor learned of the default they were in the lessor's or the supplier's possession or control; and

(b) dispose of goods (Section 2A-527(1)) that demonstrably have been intended for the particular lease contract even though those goods are unfinished.

(2) If the goods are unfinished, in the exercise of reasonable commercial judgment for the purposes of avoiding loss and of effective realization, an aggrieved lessor or the supplier may either complete manufacture and wholly identify the goods to the lease contract or cease manufacture and lease, sell, or otherwise dispose of the goods for scrap or salvage value or proceed in any other reasonable manner.

2A-525. LESSOR'S RIGHT TO POSSESSION OF GOODS.

(1) If a lessor discovers the lessee to be insolvent, the lessor may refuse to deliver the goods.

(2) After a default by the lessee under the lease contract of the type described in Section 2A-523(1) or 2A-523(3)(a) or, if agreed, after other default by the lessee, the lessor has the right to take possession of the goods. If the lease contract so provides, the lessor may require the lessee to assemble the goods and make them available to the lessor at a place to be designated by the lessor which is reasonably convenient to both parties. Without removal, the lessor may render unusable any goods employed in trade or business, and may dispose of goods on the lessee's premises (Section 2A-527).

(3) The lessor may proceed under subsection (2) without judicial process if it can be done without breach of the peace or the lessor may proceed by action.

2A-526. LESSOR'S STOPPAGE OF DELIVERY IN TRANSIT OR OTHERWISE.

(1) A lessor may stop delivery of goods in the possession of a carrier or other bailee if the lessor discovers the lessee to be insolvent and may stop delivery of carload, truckload, planeload, or larger shipments of express or freight if the lessee repudiates or fails to make a payment due before delivery, whether for rent, security or otherwise under the lease contract, or for any other reason the lessor has a right to withhold or take possession of the goods.

(2) In pursuing its remedies under subsection (1), the lessor may stop delivery until

(a) receipt of the goods by the lessee;

(b) acknowledgment to the lessee by any bailee of the goods, except a carrier, that the bailee holds the goods for the lessee; or

(c) such an acknowledgment to the lessee by a carrier via reshipment or as warehouse.

(3)(a) To stop delivery, a lessor shall so notify as to enable the bailee by reasonable diligence to prevent delivery of the goods.

(b) After notification, the bailee shall hold and deliver the goods according to the directions of the lessor, but the lessor is liable to the bailee for any ensuing charges or damages.

(c) A carrier who has issued a nonnegotiable bill of lading is not obliged to obey a notification to stop received from a person other than the consignor.

2A-527. LESSOR'S RIGHTS TO DISPOSE OF GOODS.

(1) After a default by a lessee under the lease contract of the type described in Section 2A-523(1) or 2A-523(3)(a) or after the lessor refuses to deliver or takes possession of goods (Section 2A-525 or 2A-526), or, if agreed, after other default by a lessee, the lessor may dispose of the goods concerned or the undelivered balance thereof by lease, sale, or otherwise.

(2) Except as otherwise provided with respect to damages liquidated in the lease agreement (Section 2A-504) or otherwise determined pursuant to agreement of the parties (Sections 1-302 and 2A-503), if the disposition is by lease agreement substantially similar to the original lease agreement and the new lease agreement is made in good faith and in a commercially reasonable manner, the lessor may recover from the lessee as damages (i) accrued and unpaid rent as of the date of the commencement of the term of the new lease agreement, (ii) the present value, as of the same date, of the total rent for the then remaining lease term of the original lease agreement minus the present value, as of the same date, of the rent under the new lease agreement applicable to that period of the new lease term which is comparable to the then remaining term of the original lease agreement, and (iii) any incidental damages allowed under Section 2A-530, less expenses saved in consequence of the lessee's default.

(3) If the lessor's disposition is by lease agreement that for any reason does not qualify for treatment under subsection (2), or is by sale or otherwise, the lessor may recover from the lessee as if the lessor had elected not to dispose of the goods and Section 2A-528 governs.

(4) A subsequent buyer or lessee who buys or leases from the lessor in good faith for value as a result of a disposition under this section takes the goods free of the original lease contract and any rights of the original lessee even though the lessor fails to comply with one or more of the requirements of this Article.

(5) The lessor is not accountable to the lessee for any profit made on any disposition. A lessee who has rightfully rejected or justifiably revoked acceptance shall account to the lessor for any excess over the amount of the lessee's security interest (Section 2A-508(5)).

2A-528. LESSOR'S DAMAGES FOR NON-ACCEPTANCE, FAILURE TO PAY, REPUDIATION, OR OTHER DEFAULT.

(1) Except as otherwise provided with respect to damages liquidated in the lease agreement (Section 2A-504) or otherwise determined pursuant to agreement of the parties (Sections 1-302 and 2A-503), if a lessor elects to retain the goods or a lessor elects to dispose of the goods and the disposition is by lease agreement that for any reason does not qualify for treatment under Section 2A-527(2), or is by sale or otherwise, the lessor may recover from the lessee as damages for a default of the type described in Section 2A-523(1) or 2A-523(3)(a).

If agreed, for other default of the lessee, (i) accrued and unpaid rent as of the date of default if the lessee has never taken possession of the goods, or, if the lessee has taken possession of the goods, as of the date the lessor repossesses the goods or an earlier date on which the lessee makes a tender of the goods to the lessor, (ii) the present value as of the date determined under clause (i) of the total rent for the then remaining lease term of the original lease agreement minus the present value as of the same date of the market rent at the place where the goods are located computed for the same lease term, and (iii) any incidental damages allowed under Section 2A-530, less expenses saved in consequence of the lessee's default.

(2) If the measure of damages provided in subsection (1) is inadequate to put a lessor in as good a position as performance would have, the measure of damages is the present value of the profit, including reasonable overhead, the lessor would have made from full performance by the lessee, together with any incidental damages allowed under Section 2A-530, due allowance for costs reasonably incurred and due credit for payments or proceeds of disposition.

2A-529. LESSOR'S ACTION FOR THE RENT.

(1) After default by the lessee under the lease contract of the type described in Section 2A-523(1)) or 2A-523(3)(a) or, if agreed, after other default by the lessee, if the lessor complies with subsection (2), the lessor may recover from the lessee as damages:

(a) for goods accepted by the lessee and not repossessed by or tendered to the lessor, and for conforming goods lost or damaged within a commercially reasonable time after risk of loss passes to the lessee (Section 2A-219), (i) accrued and unpaid rent as of the date of entry of judgment in favor of the lessor, (ii) the present value as of the same date of the rent for the

then remaining lease term of the lease agreement, and (iii) any incidental damages allowed under Section 2A-530, less expenses saved in consequence of the lessee's default; and

(b) for goods identified to the lease contract if the lessor is unable after reasonable effort to dispose of them at a reasonable price or the circumstances reasonably indicate that effort will be unavailing, (i) accrued and unpaid rent as of the date of entry of judgment in favor of the lessor, (ii) the present value as of the same date of the rent for the then remaining lease term of the lease agreement, and (iii) any incidental damages allowed under Section 2A-530, less expenses saved in consequence of the lessee's default.

(2) Except as provided in subsection (3), the lessor shall hold for the lessee for the remaining lease term of the lease agreement any goods that have been identified to the lease contract and are in the lessor's control.

(3) The lessor may dispose of the goods at any time before collection of the judgment for damages obtained pursuant to subsection (1). If the disposition is before the end of the remaining lease term of the lease agreement, the lessor's recovery against the lessee for damages is governed by Section 2A-527 or Section 2A-528, and the lessor will cause an appropriate credit to be provided against a judgment for damages to the extent that the amount of the judgment exceeds the recovery available pursuant to Section 2A-527 or 2A-528.

(4) Payment of the judgment for damages obtained pursuant to subsection (1) entitles the lessee to the use and possession of the goods not then disposed of for the remaining lease term of and in accordance with the lease agreement.

(5) After default by the lessee under the lease contract of the type described in Section 2A-523(1) or Section 2A-523(3)(a) or, if agreed, after other default by the lessee, a lessor who is held not entitled to rent under this section must nevertheless be awarded damages for non-acceptance under Section 2A-527 or Section 2A-528.

2A-530. LESSOR'S INCIDENTAL DAMAGES.

Incidental damages to an aggrieved lessor include any commercially reasonable charges, expenses, or commissions incurred in stopping delivery, in the transportation, care and custody of goods after the lessee's default, in connection with return or disposition of the goods, or otherwise resulting from the default.

2A-531. STANDING TO SUE THIRD PARTIES FOR INJURY TO GOODS.

(1) If a third party so deals with goods that have been identified to a lease contract as to cause actionable injury to a party to the lease contract (a) the lessor has a right of action against the third party, and (b) the lessee also has a right of action against the third party if the lessee:

(i) has a security interest in the goods;

(ii) has an insurable interest in the goods; or

(iii) bears the risk of loss under the lease contract or has since the injury assumed that risk as against the lessor and the goods have been converted or destroyed.

(2) If at the time of the injury the party plaintiff did not bear the risk of loss as against the other party to the lease contract and there is no arrangement between them for disposition of the recovery, his [or her] suit or settlement, subject to his [or her] own interest, is as a fiduciary for the other party to the lease contract.

(3) Either party with the consent of the other may sue for the benefit of whom it may concern.

2A-532. LESSOR'S RIGHTS TO RESIDUAL INTEREST.

In addition to any other recovery permitted by this Article or other law, the lessor may recover from the lessee an amount that will fully compensate the lessor for any loss of or damage to the lessor's residual interest in the goods caused by the default of the lessee.

ARTICLE 2B – SOFTWARE CONTRACTS

2B-101. SHORT TITLE. This article may be cited as Uniform Commercial Code - Software Contracts and Licenses of Information. [Computer Information Transactions]

Official Comments: The bracketed language indicates a change in title that might be considered in light of the new scope. It has not been considered or approved by the relevant groups.

2B-102. DEFINITIONS.

(a) In this article:

(1) "Access contract" means a contract to electronically obtain access to, or information in electronic form from, an information processing system. The term does not include a contract for physical access to a place, such as a theater or building.

(2) "Attribution procedure" means a procedure established by law, regulation, or agreement, or otherwise adopted by the parties, for the purpose of verifying that an electronic message, authentication, record, or performance is that of a person, or for the purpose of detecting changes or errors in content.

(3) "Authenticate" means to sign, or otherwise to execute or adopt a symbol or sound, or encrypt or similarly process a record in whole or part, with intent of the authenticating person to:

(A) identify the person;

(B) adopt or accept the terms or a particular term of a record that includes or is logically associated or linked with the authentication or to which a record containing the authentication refers; or

(C) establish the integrity of the information in a record which includes or is logically associated or linked with the authentication or to which a record containing the authentication refers.

(4) "Automated transaction" means a contract formed by electronic means or electronic messages in which the actions or messages of one or both parties will not be reviewed by an individual in the ordinary course.

(5) "Computer" means an electronic device that can perform substantial computations, including numerous arithmetic operations or logic operations without human intervention during the computation or operation.

(6) "Computer program" means a set of statements or instructions to be used directly or indirectly in a computer in order to bring about a certain result.

(7) "Cancellation" means the ending of a contract by a party because of a breach by the other party. "Cancel" has a corresponding meaning.

(8) "Consequential damages" include compensation for losses resulting from a party's general or particular requirements and needs that the other party at the time of contracting had reason to know of and which losses could not reasonably be prevented by the aggrieved party, and from injury to person or property proximately resulting from any breach of warranty. The term does not include direct or incidental damages.

(9) "Conspicuous", with reference to a term, means so written, displayed, or otherwise presented that a reasonable person against which it is to operate ought to have noticed or become aware of it. In the case of an electronic record intended to evoke a response by an electronic agent, a term is conspicuous if it is presented in a form that would enable a reasonably configured electronic agent to take it into account or react without review of the record by an individual. Conspicuous terms include but are not limited to the following:

(A) with respect to a person:

(i) a heading in capitals equal or greater in larger or other contrasting type or color than size to the surrounding text;

(ii) language in a record or display in larger or other contrasting type or color than other language or set off from other language by symbols or other marks that call attention to the language; or

(iii) a term prominently referenced in an electronic record or display which is readily accessible and reviewable from the record or display; and

(B) with respect to a person or an electronic agent, a term or a reference to a term that is so placed in a record or display that the person or electronic agent cannot proceed without taking some additional action with respect to the term.

(10) "Consumer" means an individual who is a licensee of information or informational rights that are intended by the individual at the time of contracting to be used primarily for personal, family, or household purposes. The term does not include an individual who is a licensee primarily for profit-making, professional, or commercial purposes, including agriculture, business management, and investment management other than management of the individual's personal or family investments.

(11) "Consumer transaction" means an agreement in which a consumer is the licensee.

(12) "Contract fee" means the price, fee, rent, or royalty payable in a contract within this article.

(13) "Contractual use restriction" means an enforceable restriction created by contract on use of licensed information or informational rights, including an obligation of nondisclosure and confidentiality and a limitation on scope, manner, or location of use.

(14) "Copy" means the medium on which information that is fixed on a temporary or permanent basis and in a medium from which the information can be perceived, reproduced, used, or communicated, either directly or with the aid of a device. The term includes a phonorecord.

(15) "Court" includes an arbitration or other dispute-resolution forum if the parties have agreed to use of such forum or its use is required by law.

(16) "Delivery" means the voluntary physical or electronic transfer of possession or control of a copy.

(17) "Direct damages" includes compensation for losses measured by Section 2B-708(a)(1) or Section 2B-709(a)(1). The term does not include consequential or incidental damages.

(18) "Electronic" means of or relating to electrical, digital, magnetic, wireless, optical, or electromagnetic technology or any other technology that entails similar capabilities. "**Electronically" or other similar variants have a corresponding meaning**.

(19) "Electronic agent" means a computer program or other automated means used by a person to independently initiate or respond to electronic messages or performances on behalf of that person without review by an individual.

(20) "Electronic message" means an electronic record or display that is stored, generated, or transmitted by electronic means for purposes of communication to a person or electronic agent.

(21) "Financier" means a person other than a provider of licensed information which provides a financial accommodation to a licensor or licensee in a transaction otherwise governed by Article 9 or 2A and which obtains an interest in a license or related contract right of the party to which the financial accommodation is provided.

(22) "Good faith" means honesty in fact and the observance of reasonable commercial standards of fair dealing.

(23) "Incidental damages":

(A) include compensation for any commercially reasonable charge, expense, or commission reasonably incurred by an aggrieved party after breach of contract:

(i) in inspection, receipt, transportation, care, or custody of rightfully refused copies or information;

(ii) in stopping delivery, shipment, or transmission;

(iii) in effecting cover, mitigation, return, or retransfer of copies or information; or

(iv) otherwise incident to the breach; and

(B) do not include consequential or direct damages.

(24) "Information" means data, text, images, sounds, mask works, or works of authorship.

(25) "Information processing system" means an electronic system or facility for generating, sending, receiving, storing, displaying, or processing electronic information.

(26) "Informational content" means information that is intended to be communicated to or perceived by an individual in the ordinary use of the information, or the equivalent thereof. The term does not include instructions used solely to control the interaction of a computer program with other computer programs or with a machine.

(27) "Informational rights" include all rights in information created under laws governing patents, copyrights, mask works, trade secrets, trademarks, publicity rights, or any other law that permits a person, independently of contract, to control or preclude another person's use of the information on the basis of the rights holder's interest in the information.

(28) "License" means a contract that authorizes access to or use of information or of informational rights and expressly limits the contractual rights or permissions granted, expressly prohibits, limits, or controls uses, or expressly grants less than all informational rights in the information. A contract may be a license whether the information or informational rights exist at the time of contract or are to be developed, created, or compiled thereafter, and whether or not the contract

transfers title to a copy. "License" includes an access contract and, for purposes of [the Uniform Commercial Code], a consignment of a copy, but does not include a reservation or creation of a financier's interest.

(29) "Licensee" means a transferee in an agreement and any other person authorized to exercise rights or permissions in information or informational rights in an agreement under this article, whether or not the agreement is a license. Except in an exchange of information, a licensor is not a licensee.

(30) "Licensor" means a transferor in an agreement under this article, whether or not the agreement is a license. As between a provider of access and its customer, the provider of access is the licensor, and, as between the provider of access and a provider of the content to be accessed, the provider of content is the licensor. If performance consists of an exchange of information or informational rights, each party is a licensor with respect to the information, informational rights, or access it provides.

(31) "Mass-market license" means a standard form that is prepared for and used in a mass-market transaction.

(32) "Mass-market transaction" means **a transaction within this article that is** a consumer transaction and , or any other transaction in information or informational rights directed to the general public as a whole under substantially the same terms for the same information with an end-user licensee. A transaction other than a consumer transaction is a mass-market transaction only if the licensee acquires the information or informational rights in a retail market transaction under terms and in a quantity consistent with an ordinary transaction in that market. A transaction other than a consumer transaction is not a mass-market transaction if it is:

(A) a contract for redistribution;

(B) a contract for public performance or public display of a copyrighted work;

(C) a transaction in which the information is customized or otherwise specially prepared by the licensor for the licensee other than minor customization using a capability of the information intended for that purpose;

(D) a site license; or

(E) an access contract.

(33) "Merchant" means a person that deals in information or informational rights of the kind or that otherwise by the person's occupation holds itself out as having knowledge or skill peculiar to the practices or information involved in the transaction, whether or not the person previously engaged in such transactions, or a person to which such knowledge or skill may be attributed by the person's employment of an agent or broker or other intermediary that by its occupation holds itself out as having such knowledge or skill.

(34) "Nonexclusive license" means a license that does not preclude the licensor from transferring the same information informational rights, contractual rights or permissions within the same scope to other licensees. For purposes of the [Uniform Commercial Code], the term includes a consignment of a copy.

(35) "Present value" means the value, as of a date certain, of one or more sums payable in the future or one or more performances due in the future, discounted to a date certain. The discount is determined by the interest rate specified by the parties in their agreement unless that rate was manifestly unreasonable when the transaction was entered into. Otherwise, the discount is determined by a commercially reasonable rate that takes into account the circumstances of each case when the transaction was entered into.

(36) "Published informational content" means informational content prepared for or made available to recipients generally or a class of recipients in substantially the same form and not customized for a particular recipient by an individual that is a licensor, or by an individual or group of individuals acting on behalf of the licensor, using judgment or expertise. The term does not include informational content provided in a special relationship of reliance between the provider and the recipient.

(37) "Reason to know", with respect to a fact, means that a person has knowledge of it or that, from all the facts and circumstances actually known to the person without investigation, the person should know that the fact exists. Whether reason to know is effective for a particular circumstance is determined under the standards for effective notice in Section 1-201(27).

(38) "Receive" means:

(A) with respect to a copy, to take delivery; and

(B) with respect to a notice:

(i) to come to a person's attention; or

(ii) to be delivered to and available at a location designated by agreement for that purpose or, in the absence of an agreed location:

(I) to be delivered at the person's residence, or the person's place of business through which the contract was made, or at any other place held out by the person as a place for receipt of such communications; or

(II) in the case of an electronic notification, to come into existence in an information processing system in a form capable of being processed by or perceived from a system of that type, if the recipient uses, or otherwise has designated or holds out, that system as a place for receipt of such notices.

(39) "Record" means information inscribed on a tangible medium or stored in an electronic or other medium and retrievable in perceivable form.

(40) "Refund", with respect to information to which a rejected record or term applies, means:

(A) reimbursement of any contract fee paid from the person to which it was paid or from another person that may offer to reimburse that fee, and a right to stop payment of the contract fee, on proof of purchase and return of the information and all copies within a reasonable time after delivery; and

(B) with respect to multiple products integrated into a bundled whole but retaining their separate identity and transferred for one bundled fee:

(i) if the record is rejected before or during the initial use of the bundled product and the bundled product is returned without further use, reimbursement of the entire bundled price, on proof of purchase and return of the entire bundled product and all copies within a reasonable time after delivery; or

(ii) in all other cases, reimbursement of any separately stated fee that is paid for the information to which the rejected record applies, on proof of purchase and return of all the information and all copies within a reasonable time after delivery.

(41) "Release" means an agreement not to object to, or exercise any remedies to limit, the use of information or informational rights, which agreement requires no affirmative acts by the party giving the release to enable or support the other party's use. The term includes a waiver of informational rights.

(42) "Scope", with respect to a license, means terms of the license which define:

(A) the licensed copies or information and the informational rights involved;

(B) the uses authorized, prohibited, or controlled;

(C) the geographic area, market, or location in which the license applies; and

(D) the duration of the license.

(43) "Send" means to deposit in the mail or with a commercially reasonable carrier or otherwise to deliver for, or take all necessary steps that initiate, transmission to or creation in another location or system by any usual means of communication with any costs provided for and properly addressed or directed as reasonable under the circumstances or as otherwise agreed. In addition, with respect to an electronic message, "send" means to initiate operations that in the ordinary course will cause the record to come into existence in an information processing system in a form capable of being processed by or perceived from a system of that type, if the recipient uses or by agreement or otherwise has designated or held out that system as a place for the receipt of such communications. Receipt within the time in which it would have arrived if properly sent has the effect of a proper sending.

(44) "Software" means a computer program, any informational content included in the program, and any supporting information provided by a licensor as part of an agreement.

(45) "Software contract" means a sale or contract to sell a copy of software, a license of software, or a transfer of ownership of informational rights in software, whether the software exists or is to be developed pursuant to the contract.

(46) "Standard form" means a record, or a group of related records, containing terms prepared for repeated use in transactions and so used in a transaction in which there was no negotiation by

individuals except for negotiation or customization of price, quantity, method of payment, selection among standard options, or time or method of delivery.

(47) "Termination" means the ending of a contract under a power created by agreement or law for a reason other than its breach. "Terminate" has a corresponding meaning.

(48) "Transfer", with respect to contractual rights, includes an assignment of a contract and the creation or enforcement of a financier's interest in a contract. The term does not include an agreement for the performance of contractual obligations or exercise of contractual rights through a delegate or a sublicensee.

(b) Article 1 contains general definitions and principles of construction which apply throughout this article. In addition, the following definitions in other articles of [the Uniform Commercial Code] apply to this article:

"**Financial asset**"	Section 8-102(a)(9)
"**Funds transfer**"	Section 4A-104 (as applied to credit orders)
"**Identification**" to the contract	Section 2-501
"**Instrument**"	Section 3-305
"**Item**"	Section 4-104
"**Investment property**"	Section 9-115(f)
"**Letter of credit**"	Section 5-102
"**Negotiable instrument**"	Section 3-104
"**Payment order**"	Section 4A-103 (as applied to credit orders)
"**Sale**"	Section 2-106

Official Comments:

1. "Access contract." This term is new. An access contract is a contract that authorizes access to an electronic facility, including a computer or an Internet site, or a contract that authorizes obtaining information from that type of facility. The term does not include contracts that grant a right to physically enter a building or other physical location, nor does it include the purchase of a television, radio, or other similar goods that create an ability to access electronic data. An "access contract" is typified by "on-line" services and Internet transactions. It also includes contracts for remote data processing, third party E-mail systems, and contracts allowing automatic updating from a remote facility to a database held by the licensee. It does not include ordinary interactions among computer programs within a single system that are permitted simply because each program is licensed such transactions do not involve access to a facility.

Access contracts do not depend on intellectual property rights. The owner of a computer system has a fundamental right recognized in criminal law and property law to exclude others from access to its system and to condition the terms on which it permits access to occur. Access contracts may distribute rights on the basis of informational rights, but they also reflect the right to control use and access. This does not mean that identical information cannot be obtained elsewhere, but merely that obtaining the information from the access provider can be conditioned on assent to its own terms of access. The access provider can contract for its data and establish contractual terms of access that bind the other contracting party even though the licensee could, if it chose, obtain identical information from other sources or its own research.

An access provider may, or may not, be in a position to give contractual rights in the information accessed by the licensee. In some cases, the information is controlled by the access provider, while in others there is a three-party framework. In the three-party relationship, one party provides access, while another (the content provider) licenses use of the information. This latter transaction involves two and, in some cases, three separate contracts. The first is between the content provider and the access provider. This may be an ordinary license or an access contract that gives the access provider a right provide a gateway to access information contained in a system controlled by the content provider. The second is between the access provider and the end user. This is the access contract. The third arises if the content provider contracts directly with the end user. The various contracts are independent of each other.

2. "Attribution procedure." This term is new. It deals with electronic commerce and refers to agreed on, adopted, or otherwise established procedures to identify the person who sent an electronic message or verify the absence of changes in the content of the message. Electronic commerce is fundamentally anonymous in character and depends on such procedures and their recognition in law and practice. The effect of an attribution procedure is discussed in Sections 2B-114 to 2B-117. The benefits of using

an attribution procedure only pertain to procedures that are commercially reasonable. In general, a use of a commercially reasonable procedure for attribution entitles the user to a presumption that the facts are as established by the procedure.

3. "Authenticate." This term replaces "signature" or "signed" in this article. It incorporates and expands on the traditional idea and general effect of a signature. As in that definition, adoption or execution of a symbol or the taking of an action is an authentication only if accompanied by an objective manifestation of intent with which the party authenticating a record acts. Adoption or execution of electronic or other text or a symbol with intent authenticate a record that would be a signature under prior law is an authentication under Article 2B. This includes use with requisite intent of identifiers such as a PIN number. In addition, the term includes actions and sounds such as encryption of a record, voice identification, and other technologically enabled acts used to achieve the legal effects associated with a traditional signature.

The definition spells out three effects of an authentication; this enumerates the effects given to signatures under prior law. No change in law is intended. Which effect is intended must be determined, as it is under prior law, by the context and the objective indicia of intent associated with that context. Unless the circumstances indicate a different intent, authentication contemplates all three of the effects listed.

The definition is technologically neutral. "Digital signatures", recognized in some states and which rely on a specified encryption technology and a certification system, qualify as authentication for Article 2B. The Article 2B concept is broader however. It recognizes that technology and commercial practice will evolve. There is no effort to set a minimum standard of sufficiency for an authentication, rather unreliable procedures that purportedly authenticate a record are subject to evidentiary scrutiny as to whether they were used with the requisite intent, whether they were the act of the purported party, and other issues.

4. "Automated transaction." This term is new. It refers to relationships formed and made effective as a contract even though one or both of the parties are represented by an electronic system, rather than a human being. Automated contracting is widely used. While law could adopt a fiction and attribute intent to these automated activities, this Article directly recognizes that operations of automated systems can create binding legal obligations for those who use them for that purpose.

5. "Cancellation" is from existing Article 2-106. The effect of cancellation is stated in 2B-702.

6. "Computer program." This term is new and parallels the definition in the federal Copyright Act. 17 U.S.C. 101. In this article, a distinction exists between programs as operating instructions and "informational content" communicated to people. "Computer program" refers to functional and operating aspects of a digital system, while "informational content" refers to output that communicates to a human being. There is an inevitable overlap. However, if issues arise that require a close distinction, the answer lies in whether the issue addresses functional operations (program) or communicated content (informational content). The distinction is like the made in copyright law between a computer program as a "literary work" (code) and the program interface or other output as an "audiovisual work" (images, sounds). In copyright, the distinction relates to what reference points are used in determining whether a copyrighted work was created or infringed. In Article 2B, the distinction relates to contract law issues relevant in determining liability risk and performance obligations.

7. "Consequential damages" corresponds to existing Article 2. Consequential damages do not include "direct" or "incidental" damages. Consequential loss deals with loss of benefits anticipated as a result of having received and being able to exploit the contracted performance. Consequential damages include lost profits resulting from that lost opportunity, damages to reputation, lost royalties expected from a licensee's proper performance, lost value of a trade secret from wrongful disclosure or use, wrongful gains for the other party from misuse of confidential information, loss of privacy, and loss or damage to data or property caused by a breach.

Consequential damages may be recovered by either party. The losses must be an ordinary and predictable result of the breach. In the case of economic and similar losses, they must be foreseeable. This means that, in order for the injured party to recover compensation for losses resulting from its **special** circumstances, the party in breach must have had actual notice of those circumstances at the time of contracting. The particular needs and circumstances must be made known at that time. In contrast, losses from ordinary general requirements can often be presumed to have been within the contemplation of the other party.

The burden of proving loss is on the party claiming damages. This Article does not require proof with absolute certainty or mathematical precision. Article 1 requires liberal administration of remedies, but does not permit recovery of losses that are speculative or otherwise highly uncertain or unproven. See Section 2B-707 and **Restatement (Second) of Contracts** 352 ("Damages are not recoverable for loss beyond the amount that the evidence permits to be established with reasonable certainty."). No change

in law on this issue is intended. See **Freund v. Washington Square Press, Inc.**, 34 N.Y.2d 379, 357 N.Y.S.2d 857, 314 N.E.2d 419 (1974) ("[Plaintiff's] expectancy interest in the royalties ... was speculative.").

The definition does not specifically refer to mitigation, but that concept applies under Section 2B-707(c). No change in law is intended by deletion of the reference "cover" from the Article 2 definition.

The definition continues current law as to recovery of damages for personal injury that "proximately" resulted from the breach.

8. "Conspicuous." This definition follows existing Article 2, but adds new concepts for electronic commerce. The basic standard is that a term is conspicuous if it is so positioned or presented that the attention of a reasonable person can be expected to be called to it. Under this general standard, in the case of an individual, the concept could include properly presented verbal or automated voice communications. Whether a term is conspicuous is determined by the court. Section 2B-106.

Many transactions are automated using electronic agents. Electronic agents do not "notice" text or images in the sense in which this idea is ordinarily used; they respond operationally to in-put. Conspicuous there requires presentation in a form capable of invoking a response from a "reasonably configured" electronic agent.

Both current UCC § 1-201(10) and this Article list illustrations of conspicuous terms The list plays an important role in commercial practice. The purpose of requiring that a term be conspicuous blends a notice function (the term ought to be noticed) and a planning function (giving certainty to the party relying on the term). The illustrations establish safe harbors intended to reduce uncertainty and litigation. Absent exceptional circumstances, a term that conforms to a safe harbor is conspicuous. The illustrations, however, are not exclusive. In cases outside the illustrative safe harbors, a court should apply the general standard.

Subsection (A) rejects the current rule that all terms in a "telegram" are conspicuous. A "telegram" includes "any mechanical method of transmission, or the like." No per se rule is justified.

Subsection (A)(ii) contemplates setting the term or its label off by symbols which can be reliably transferred in electronic commerce. Thus, a term that provides *** Disclaimer *** is conspicuous, as is a term that provides <<< Disclaimer >>>.

Subsection (A)(iii) deals with hyperlink and related Internet technologies. It contemplates a case in which a computer screen displays a term, a summary or reference to the term, or an image and the party using the screen, by taking an action with reference the display is transferred to a different file or location wherein the relevant contract term is available. To be conspicuous, the image, term, or summary must be prominent and its use must readily enable review of the term itself. The access must be from the screen or display and not through other actions such as a telephone call or physically going to another location. When the term is accessed, it must be in a form that can be readily reviewed.

Subsection (B) recognizes a procedure by which, without taking action with respect to the term, the party cannot proceed further in reference to the file or location. Thus, a screen that states: "There are no warranties of accuracy with respect to the information" and is displayed in a form that precludes the user from moving further in the system without expressing assent to this condition, suffices under this concept.

9. "Consumer." This definition adapts the Article 9 definition of "consumer goods." A "consumer" is a person who obtains information for personal, household, or family purposes. Whether a party is a consumer is determined at the time of contracting.

In many transactions, "personal" uses are not consumer uses (e.g., a stock broker using software to personally monitor client investments). Thus, the definition distinguishes profit making, professional or business use, from non-business personal or family use. It includes, as consumer use, ordinary asset management for a family.

This resolves an issue faced in many areas of law where distinguishing between consumer and non-consumer "personal" use is difficult. It adopts the general view that a transaction aimed at providing information for profit-making or income product by the transferee is not a consumer transaction, unless related to ordinary family asset management. The profit-making standard has been applied by courts in many settings. See, e.g., **Thomas v. Sundance Properties**, 726 F.2d 1417 (9th Cir. 1984); **In re Manning**, 126 B.R. 984 (M. D. Tenn. 1991). In re Booth, 858 F.2d 1051 (5th Cir. 1988) (The "profit-making" test has been applied in bankruptcy cases. The Fifth Circuit commented that "[The] test for ... whether a debt should be classified ... a debt [is] acquired for personal, family or household purposes is whether it was incurred with an eye toward profit."); **In re Circle Five, Inc.,** 75 B.R. 686 (Bankr. D. Idaho 1987) ("Debt used to produce income is not consumer debt primarily for a personal, family or household purposes."). The Truth in Lending Act uses a definition much like Article 9 but expressly exempts business transactions.

10. "Contract fee" recognizes the various forms and methods of monetary compensation encountered in information transactions. The phrase refers to essentially any money payment under a contract.

11. "Contractual use restriction." This definition includes any enforceable restriction on use or disclosure of the information or informational rights dealt with by a contract and created in that contract. It does not include limitations imposed by property or regulatory law, such as copyright or patent law, without contract terms. The adjective "enforceable" clarifies that the definition does not include terms invalidated under this Article or other law, including federal intellectual property law and state laws which limit enforcement of some restrictions on use of information. Thus, for example, if applicable trade secret law precludes enforcement of a particular non-disclosure term, that term is not a contractual use restriction as used in this Article to the extent of such preclusion. Similarly, if a state law that restricts the enforceability of a contractual non-competition clause applies to contracts within Article 2B, a restriction that would not be enforceable under such law is not a "contractual use restriction."

12. "Copy." The definition corresponds to copyright law. It does not deal with whether under that law a brief reproduction in computer memory is an infringement. Compare **MAI Systems Corp. v. Peak Computer, Inc.**, 991 F.2d 511 (9th Cir. 1993), with **Lewis Galoob Toys, Inc. v. Nintendo of America,** 964 F.2d 965 (9th Cir. 1992). In Article 2B, the term relates to performance questions associated with contractual events such as delivery, tender, and enabling use. For these purposes, the copy can be temporary or permanent.

13. "Court" includes officers of non-judicial forums such as arbitration.

14. "Delivery" in electronic technology can occur either through a change of possession of a tangible copy or through electronic transfer. For determining whether a delivery occurred, the methodology of transfer does not alter the result.

15. "Direct damages." Direct damages are losses associated with the value of the contracted for performance itself as contrasted to loss of an expected benefit from intended use of the performance or its results. Direct damages are measured by the formulae in Section 2B-708 and 2B-709. They are capped by either the contracted for price or the market value of the performance, as appropriate. The definition rejects cases that treat as direct damages losses that relate to anticipated advantages from the use of the information. These are consequential damages. Thus, if software is purchased for $1,000 and, if perfect, would yield profits of $10,000, but it is totally defective, "direct" damages are $1,000. The $9,000 lost profits are consequential damages if recoverable at all.

16. "Electronic." While most modern information systems entail electrical technologies, the term here is open-ended. It encompasses other forms of information processing technology as may be developed in the future.

17. "Electronic agent." This includes a computer program used for the stated purposes, but is not limited to software technology. The definition and its use in this Article recognize that many aspects of commerce are automated and that automation is expanding. In an automated system, an individual does not deal with another individual, but one or both parties are represented by automated systems. As indicated in Section 2B---- and elsewhere in this Article, the relationship between the person and the automated system here is not fully equivalent to common law agency, but takes into account that the "agent" is not a human actor, but an automated system.

To constitute an electronic agent, the automated system must have been selected, used or programmed for that purpose.

18. "Electronic Message." A message is distinguished from a "record" by the fact that it is to be communicated to another. In many systems, communication to another person does not require that the message be transmitted to a new location; the recipient and the person creating the message may share a common E-mail system or other resource and the message can be "stored" for purposes of communicating to another.

19. "Financier." This definition includes secured parties and lessors. This Article does not deal with financing informational property rights. That is governed by Article 9 and federal or other state law. The financing here involve contractual rights.

20. "Good Faith." The definition expands the duty of good faith to encompass fair dealing and to relate to consumers. It follows current Article 3.

21. "Incidental damages." Incidental damages include costs of seeking or arranging cover or other mitigation, but do not extend to the actual expenditure for the mitigation itself. Thus, if a licensee must obtain a different computer program because of a breach, the telephone calls and related expenses in arranging for the cover are incidental damages. The cost of the new program may be considered in computing direct damages.

22. "Information." This definition establishes a broad construction of information. The term, "work of authorship" comes from the Copyright Act. It includes literary works, computer programs, motion pictures, compilations, collected works, audiovisual works and the like. It also includes "data", that is factual information. In this Article, information is the broad term; in appropriate situations more specific reference is made to particular types of information, such as computer programs and informational content.

23. "Informational content." This term refers to information whose ordinary use entails communicating the information to a human being. This is the information people read, see, hear and otherwise experience. For example, an electronic database of images includes the images and a program enabling display or access to the images. The functional aspects of the program are not informational content. The images are informational content. Similarly, the Westlaw search program used to obtain a case is not informational content, but the recovered text is.

24. "Information processing system." This definition corresponds to the UNCITRAL Model Law on Electronic Commerce. It includes computers, but also other forms of information processing systems.

25. "Informational rights." This term includes, but is not limited to "intellectual property" rights. It refers to any law that gives a person a right to control another's use of information independent of contract. This Article does not create property rights; the definition references other law to determine when rights exist. The rights need not be comprehensive or exclusive as to all other persons. The term includes the areas of law in which new forms of property are being created, but does not include the right to sue for defamation.

26. "License." A license is a limited or conditional transfer of information or rights in information. The contractual limitations must be express. A license does not exist merely because intellectual property law withholds rights from the transferee. The term does not include a sale of a copy of a book since there is no express contractual restriction on use of the information. In such sales, the buyer receives ownership of the copy, but copyright (or patent) law may place restrictions on use. Restrictions flowing solely from retained ownership of information rights do not create a license.

On the other hand, whether a license exists does not depend on whether or not there has been a transfer of ownership of a copy. Ownership of a copy is analytically and commercially distinct from questions about the extent to which use of the information is controlled by a license. Licenses pertain to rights or restrictions on use of information. The tangible copy is the conduit, not the focus.

If ownership of a copy transfers, a "copyright notice" which merely tracks the privileges and restrictions associated with a first sale under copyright law does not transform the sale into a license. However, an contract is a license if it grants greater privileges than in a first sale, restricts what use privileges might otherwise apply, or deals with issues that are not explicit results of a first sale. Whether terms are enforceable is determined under this Article and otherwise applicable federal and state law.

27. "Licensor" and "Licensee." These definitions refer to the transferee and transferor in any contract covered by this article, whether or not the contract is a license.

28. "Mass-market license" and "Mass-market transaction." These definitions are new.

"Mass market" expands consumer protections into a marketplace of transactions even if a particular transaction does not involve a consumer. The definition must be applied in light of its intended function. That function is to identify relatively small dollar value, routine and anonymous transactions that occur in a retail market available to and used by the general public. The term includes all consumer transactions and some transactions involving business licensees. It does not include ordinary commercial transactions in marketplaces characterized primarily by transactions between businesses using ordinary commercial methods of ordering and transferring commercial information.

A mass market is a retail market where information is made available in pre-packaged form under generally similar terms to the general public and in which the general public is a frequent participant. The concept applies only to information aimed at the general public as a whole, including consumers. It does not include products directed at a limited subgroup of the general public or restricted to members of an organization or to persons with a separate relationship to the information provider. In determining the size or scope of a subgroup that qualifies as a distribution directed to the general public courts should make choices based on the purpose of the definition which is to not make artificial distinctions among business and consumer purchasers in an ordinary retail market. The transactions covered are purchases in a true mass market and do not include specialty software, information for specially targeted limited audiences, commercial software distributed in non-retail transactions, or professional use software. The transactions refer to materials routinely acquired by consumers or materials that appeal and intend to appeal to a general public audience as a whole including consumers.

The prototypical retail market is a department store, grocery store, gas station, shopping center, or the like. These locations are open to, and in fact attract, the general public as a whole. They are also

characterized by the fact that, while the retail merchants may make transactions with other businesses, the predominant transaction type involves consumers. Also, in a retail market, the majority of the transactions involve relatively small quantities, non-negotiated terms, and transactions to an end user rather than a purchaser who plans to resell the acquired product. The products are available to anyone who enters the retail location and can pay the applicable price.

The transaction must be with an end user. An end user is a licensee that generally intends to use the information or the informational rights in its own internal business or personal affairs. An end user in this sense is not engaged in the business of reselling, distributing, or sublicensing the information or rights to third parties, or in commercial public performances or displays of the information, or in otherwise making the information available commercially to third parties.

The definition contains several exclusions where the person acquiring the information is a commercial entity. A transaction for redistribution or for public display or performance of a copyrighted work is never a mass market transaction because it involves no attributes of a retail market. Similarly, a bifurcated treatment of access (Internet) transactions occurs. While consumer transactions on Internet are mass market transactions, the term does not include online transactions not involving a consumer. In this new transactional environment, it is important to not regulate transactions beyond consumer issues. This gives commerce room to develop while preserving consumer protections. It is consistent with the 1997 White House paper on electronic commerce.

29. "Merchant." This definition comes from Article 2-104. It alters that definition in that it specifically a person that holds itself out as experienced in particular subject matter need not have actually engaged in prior transactions of the type involved to qualify as a merchant.

As indicated in comments to Article 2, the definition applies differently depending on the context. In Article 2B, the term refers primarily to businesses with general knowledge of business practices, rather than to experts in a specific field. Section 2B-307, 2B-401 and 2B-403, however, require a more focused expertise in the particular type of information involved.

30. "Non-exclusive license." This is the most common commercial license. It is characterized by the fact that the licensor grants very limited rights and does not foreclose itself from making additional licenses involving the same subject matter and general scope.

31. "Present value." This definition corresponds to Article 2A-103 and Article 1-201(37)(z). It modifies those rules to cover present valuation of performances other than future payments.

32. "Published informational content." This definition covers the information most closely associated with First Amendment and related public policy concerns. This is the material of newspapers, books, motions pictures and the like, which is distributed to the public and intended to communicate knowledge, sounds, or other experiences to a human being, rather than simply to operate a machine. The term includes interactive content since, in those products, all of the information is generally available and the end user selects from the available information. This is like the reader of a newspaper focusing on part, but not all of the newspaper.

32a. "Reason to know." This definition is new. While Article 1 defines notice and knowledge, it does not define reason to know. The definition is consistent with the usage of the term, which refers to knowledge and inferences from information actually known to the person. No constructive knowledge, notice, or duty to investigate exists under this concept.

33. "Receive." This definition, as to performances, corresponds to Article 2-103. As to notices, it updates Section 1-201(26) to reflect use of electronic systems to give and receive notice.

34. "Record." This definition adopts modern U.C.C. usage. It broadens the traditional reference to "writing" and incorporates electronic records. It does not require permanent storage or anything beyond temporary recordation. Fixation can be fleeting and perception can be either directly or indirectly with the aid of a machine.

35. "Refund." A refund consists of a reimbursement of fees paid on return of all copies of the information. Whether or when a right to a refund exists depends on the contract and this Article. Refund is not a remedy for breach or a right of rescission. It is a right that arises when a party refuses a proffered license and has previously committed to, or paid, the contract fee. Making a refund available in such cases is essential to allow the party a true opportunity to accept or reject that license. See Sections 2B-111 and 2B-112. The right to refund there expires if the party agrees to the license, including by manifesting assent to it. Of course, if a party accepts a license but the information is defective, the aggrieved party may have a right to restitution of the contract fee as direct damages.

Refund must be sought within a reasonable time. If a party fails to seek refund within a reasonable time of the opportunity to review, it will not be entitled to refund under this Article, but expiration of a refund right does not result in assent to the license. Affirmative agreement or assent is still required. What constitutes a reasonable time depends on the facts and the contract.

The definition deals with the difficult problem of administering a refund right in "bundled" products, that is products that include separate items of information transferred as a whole for a single fee. If the products are subject to separate licenses, a refund in such situations consists of the entire bundled product in return for the entire price. Otherwise, a refund consists of price contractually attributable to the particular, returned product. The price must be separately stated in the sense that the agreement identified an amount allocated to the particular information. A court cannot unbundle the products and estimate appropriate pricing in what is often a complex arrangement for distribution that is based on the fact of bundling multiple products.

36. "Release." A release is a waiver or permission not accompanied by other commercial attributes, such as an on-going obligation to pay or an obligation to provide the means to implement use of the information.

37. "Scope." This term refers to contract provisions that define an integral part of a license. Scope provisions in a license are equivalent to defining the product. In sales or leases of goods, products are self-defining: an offered car is either a Ford or Chevrolet, it is not necessary to read a contract to determine that. That is not the case for the information industries: In many situations, the license and its scope is the product. The same information has entirely different characteristics as a commercial subject matter depending on what scope of rights are granted. For example, a license that allows use of a motion picture in a single theatre is not the same product as a license to distribute the motion picture throughout the United States. Neither license transfers the same product as a license to use a copy of the motion picture for three days in one's home. The scope provisions define the product.

38. "Software contract" includes licenses of software and sales of copies of software. It also covers all forms of software development contracts, whether or not they formally fall within the Copyright Act definition of a "work for hire." Of course, however, the Article generally excludes employment contracts and, thus, does not extend to the contractual arrangement under which an employee of a firm develops software for the employer within the scope of the employee's job.

39. "Send." This definition adapts Article 2-201(38) by providing criteria relevant to electronic notices.

40. "Standard form." The definition refers to forms, not standard terms. See Restatement (Second) of Contracts 211 (referring to but not defining standard forms). A form consists of a group of terms prepared for frequent use. Standard forms in modern commerce are not only widespread, but virtually ubiquitous. The definition does not cover a tailored contract comprised of "terms" selected from prior agreements. The record must itself have been prepared for repeated use and actually have been used without negotiation. If a standard form is offered but then heavily negotiated or changed, the resulting contract is not a standard form contract.

41. "Terminate." This definition conforms to Article 2-106.

[B. General Scope and Terms]

2B-103. SCOPE.

(a) Except as otherwise provided in Section 2B-104 on excluded transactions and in subsection (b), this article applies to:

(1) any transaction that creates a software contract, access contract, or license; and

(2) any agreement to provide support for, maintain, or modify information related to a contract within the scope of this article.

(b) If this article governs part of a transaction and other contract law governs part, the following rules apply:

(1) This article applies to the information, informational rights, copies that contain the information, its packaging, and its documentation.

(2) Article 2 or 2A governs as to goods not within paragraph (1) and as to subject matter that is excluded under Section 2B-104(3).

(3) The rules of this article on contract formation apply to the entire transaction if:

(A) the parties agree to be bound by those rules; or

(B) except with respect to subject matter of paragraph (2), the transaction involves services or other subject matter not within this article or Article 2 or Article 2A and the information or services that are within the scope of this article are the predominant purpose of the transaction.

(c) The parties may agree that this article governs in whole or in part any transaction or a part thereof not otherwise within the scope of this article. Such an agreement is not effective to the extent it:

(1) would alter mandatory consumer protection rules that apply under otherwise applicable law; or

(2) applies to a transaction to which this article does not otherwise apply and that is governed by Article 2 or Article 2A of [the Uniform Commercial Code].

Definitional Cross Reference:

"Access contract": Section 2B-102. "Agreement": Section 1-201. "Computer": Section 2B-102. Contract": Section 1-201. "Consumer": Section 2B-102. "Copy": Section 2B-102. "Information": Section 2B-102. "Informational Rights": Section 2B-102. "License": Section 2B-102. "Party": Section 1-201. "Rights": Section 1-201. "Software contract": Section 2B-102.

Official Comments:

1. *General Premise.* This article deals with licenses and software contracts in the copyright and information industries. It does not cover sales of books, newspapers, or magazines, or personal or entertainment services contracts. The Article focuses on software and multi-media contracts, access contracts involving on-line and Internet transactions, and licenses of data, text, images, and related information.

The scope of the Article is defined by this Section and the exclusions in Section 2B-104. Because of rapidly converging information technology and commercial practice, the scope reflects a broad focus counterbalanced by exclusions in Section 2B-104. This parallels the approach in Article 9. See Section 9-104 (13 exclusions).

The covered transactions involve information and rights to use the information. However, this is a contract statute. It does not alter any law creating or limiting intellectual property rights or privileges in information.

2. *Basic Scope.* Subsection (a) states the basic scope of Article 2B. That scope is subject to the limitations in Section 2B-104. Subsection (b) deals with mixed transactions and the parties' right to opt in to Article 2B. Subsection (c) confirms an opt-in rule for excluded transactions.

a. *Software Contracts.* A "software contract" is a (1) license of software, (2) a sale of a copy of software, or (3) a contract to develop software. Except for some software contained in another product, all software contracts are included.

b. *Access Contracts.* Article 2B covers access contracts. This includes Internet and on-line services. Thus, a contract with Westlaw is within this Article, as are the various specific access events that occur pursuant to the contract. Also included are cases where information is available for a fee at a Website and obtained by contractual access to the information electronically. Of course, since this is a contract statute, it does not cover situations where information is simply made available and no contract exists. Also, except where the material accessed is within this article (i.e., software or included information licenses), the article applies to the access contract, but other law applies, for example, to the terms for sale of goods purchased through the access.

c. *Licenses.* Article 2B applies to licenses. A "license" is a contract for conditional rights, privileges, or permissions to use information, an information processing resource, or an informational property right. A license exists only if the contract expressly conditions the rights or permissions conveyed or expressly grants less than all rights in the information. Section 2B-102. Except for computer software, this Article thus does not deal with unrestricted sales of copies of information even though sales of copies are subject to restrictions under copyright or patent law.

d. *Incidental Licenses.* Article 2B adopts a gravamen of the action test which recognizes that different bodies of contract law may apply to different aspects of a transaction. Under Section 2B-104(1), however, notwithstanding that basic principle, this Article does not apply if the information is a mere incident of excluded subject matter. See notes to Section 2B-104.

3. *Transactions Covered / Transactions Excluded.* Because of the convergence of information technologies and diverse modern commercial uses of information, the scope of this Article inevitably involves some areas of uncertainty. This has also been true with respect to Article 2 where the scope ("transactions in goods") has generated extensive litigation. The following discussion draws on both this Section and Section 2B-104 to outline some areas of coverage and some areas of exclusion.

a. *Computer Programs.* This Article applies to computer software transactions, whether the software is sold or licensed. This includes both software provided as a separate product (e.g., word processing software acquired in the mass market or specially developed for a licensee) as well as software provided as part of a multi-faceted product. Most software contracts do not occur in the mass market. The Article covers those transactions and also information licensed to be included in software (e.g., images or text for digital inclusion).

In mixed transactions, in determining what contract law applies, Article 2B adopts two rules. First, as a general principle, other law (e.g., Article 2 and Article 2A) applies to the goods involved in a transaction. Article 2B applies to the program and the materials that comprise the copy of the program. Section 2B-103(b). This is a gravamen of the action test holding that, in the case of a dispute, a court must determine in reference to which aspect of the mixed deal the issue arise.

Second, where computer programs or chips are embedded in and used to create "intelligent products", Article 2B applies to a program that is part of a computer system or peripheral, but in other products only to the program if giving the purchaser access to the program's capabilities is a "material purpose" of the transaction. Section 2B-104(3)(C). Thus, Article 2B does not apply to the computer program that operates the brakes in a motor vehicle and is sold as part of the automobile. There, the purchaser acquires a vehicle and not the processing power of the program. On the other hand, the transaction in which a vendor develops and provides the brake software to the car manufacturer is an Article 2B transaction. Similarly, while a home air conditioning system has some functions operated by a program, the program is either merely incidental to the overall system or, as an embedded program, is not included because acquiring it was not a primary purpose of the transaction for the purchaser. The transaction is within Article 2. The development or supply contract for the program, however, is an Article 2B transaction.

b. *Books, Newspapers, Magazine, Videos and Records.* Article 2B does not apply to sales of printed, videos, and records. Except for software, the Article is limited to **licenses**. Licenses are contracts that *expressly regulate* use of acquired information.

Information similar to printed works, however, is frequently made available via Internet and other on-line systems. While Article 2B does not apply to broadcast information, it does cover on-line access contracts where the information is made available at a time and place of the licensee's choosing. Contracts for access to electronic newspapers and texts are within Article 2B.

Technology enables interactive or multimedia products such as, for example, a digital encyclopedia or a baseball dictionary that shows text, images and gives access to online updates of performance. These are software products in which software-created capabilities and information central to the product; they are within Article 2B.

c. *Patent and Trademark Licenses.* This Article does not apply to most patent or trademark licenses not associated with an access contract or a software contract. See Section 2B-104(2). Thus, a license of a biotechnology patent and associated know how, or a license of a trademark as part of a franchise agreement for a popular food store are not within Article 2B. In the case of the patent, the basic judgment is that the areas of general patent licensing do not involve the same commercial law concerns that are central to transactions covered in Article 2B. In fact, many pure patent licenses are primarily intended to settle or avoid litigation. In reference to trademarks, licenses often fall under state and federal franchise laws and are covered by principles unrelated to the commercial issues treated here.

Access and software contracts, however, also involve trademarks or patents. These are included in Article 2B. Thus, a license of a software operating system includes not only a copyright license, but also a right to practice the various technologies covered by a patent held by the software provider. The entire license is within Article 2B.

d. *Access and Broadcast.* While Article 2B applies to access contracts, the term is limited to electronic access. Thus, for example, a contract giving a person a right to enter and use a physical library facility, or a motion picture theater, is not within Article 2B. What law applies is not clear.

Similarly, Article 2B does not apply to regularly scheduled broadcast or cable programs or contracts giving access to such programming. These regulated activities involve long-established contracting practices. Differentiating between this type of information distribution and on-line systems is based on both the regulated status of the broadcast and cable industries and the fact that they provide regularly scheduled programs, while on-line systems make information available at a time and place of a user's choosing. This latter differentiation is used in regulatory definitions and in an international copyright treaty.

While the access contracts are covered, the subject matter of the contract may not be within Article 2B. For example, if a customer purchases a television set under an access contract, the access contract is within Article 2B, but the purchase is an Article 2 transaction. Similarly, in the use of an access contract to order a transfer of cash to pay a utility bill, the access conduit is in Article 2B, but the excluded cash transfer is not.

5. *Formation Rules.* Subsection (b)(3) addresses an effect created by Article 2B contract formation rules and the fact that Article 2B validates electronic commerce practices that may not be effective under common law or under current Article 2 or 2A. The subsection applies Article 2B formation rules to the entire transaction if Article 2B subject matter constitutes the predominant purpose of the transaction itself. This allows maximum scope to the contract formation rules and electronic commerce.

6. *Opt-In Rules.* Subsection (c) allows the parties to elect full coverage under either Article 2B or other applicable law. This states a rule that would most likely be applicable in any event under general contract law principles. The rule here, however, cannot be used to alter mandatory consumer rules or to take a transaction that does not involve subject matter included in this article and is under Article 2 or 2A into this Article.

2B-104. TRANSACTIONS EXCLUDED FROM ARTICLE. This article does not apply to the extent that a transaction:

(1) is a license or software contract that as between the licensor and licensee is only an incident of subject matter not governed by this article;

(2) is a license of a trademark, trade name, trade dress, patent, or related know-how not associated with a license or software contract that is otherwise covered by this article;

(3) is a sale or lease of a copy of a computer program as part of a sale or lease of goods that contain the computer program unless:

(A) the goods are merely a copy of the program;

(B) the goods are a computer or computer peripheral; or

(C) giving the purchaser of the goods access to or use of the computer program is a material purpose of the transaction;

(4) provides access to, use, transfer, clearance, settlement, or processing of:

(A) a deposit, loan, funds or monetary value represented in electronic form and stored or capable of storage electronically and retrievable and transferable electronically, or other right to payment to or from a person;

(B) an instrument or other item;

(C) a payment order, credit card transaction, debit card transaction, or a funds transfer, automated clearing house transfer, or similar wholesale or retail transfer of funds;

(D) a letter of credit, document of title, financial asset, investment property, or similar asset held in a fiduciary or agency capacity; or

(E) related identifying, verifying, access-enabling, authorizing, or monitoring information;

(5) is a contract for personal or entertainment services by an individual or group of individuals, other than a contract with an independent contractor to develop, support, modify, or maintain software;

(6) is a license for regularly scheduled audio or video programming by broadcast or cable as defined in the Federal Communications Act as that Act existed on January 1, 1998, or any similar regularly scheduled programming service; [or]

(7) is a compulsory license under federal or state law; [or]

(8) is a license of a linear motion picture or sound recording or of information to be included therein, except in connection with providing access to such motion picture or sound recording under an access contract covered by this article.]

Definitional Cross References:

"Access contract": Section 2B-102. "Computer": Section 2B-102. "Computer program": Section 2B-102. "Copy": Section 2B-102. "Electronic": Section 2B-102. "Financial asset": Section 8-102. "Funds transfer": Section 4A-104. "Information": Section 2B-102. "Instrument": Section 3-305. "Item": Section 4-104. "Investment property": Section 9-115. "Lease": Section 2A-103. "License": Section 2B-102. "Letter of credit": Section 5-102. "Sale": Section 2-106. "Software". Section 2B-102. "Software contract". Section 2B-102. "Value": Section 1-201.

Notes:

1. *General Approach*. This Section states various exclusions from Article 2B. The approach of a broad scope with specific exclusions follows the approach of Article 9.

Even with a broad scope, of course, since most provisions can be altered by agreement and defer to customs of trade, course of dealing, or formal contracts define the relationship, Article 2B will have little impact on established commercial practice.

2. *Licenses that are Incidents of Excluded Subject Matter.* This Article does not apply if the information is a mere incident of an excluded subject matter contract. Thus, a services contract to provide legal advice to a client may result in the delivery of a memorandum or other document containing information whose use may be restricted by contract. The information does not fall within this Article; the services

are not within the Article and the information is a mere incident of that services relationship. Of course, if services providers engage in broader activities, Article 2B applies. Similarly, services of an independent contractor hired to develop software, are in Article 2B.

The exclusion may work differently at different stages of distribution. Thus, an courier company that acquires a license for communications software is engaged in an Article 2B transaction. When the courier provides the software to customers as merely a means to access data on the location of packages, that is a mere incident of the excluded services as to the courier. As to the publisher, however, if there is a publisher's license with the end user, that relationship is in Article 2B. If the software also enables access to other information resources, the software is not a mere incident to the courier services.

3. *Patent and Trademark Licenses.* Subsection (2) excludes patent and trademark licenses not associated with the other subject matter of the Article. The basic principle is that, if the only basis for bringing a transaction under Article 2B lies in the existence of a trademark or patent license, the transaction is not under this Article. The rationale lies in the differences between copyright and digital licensing and practices in unrelated areas of patent law. Patent licensing relating to biotech, mechanical and other industries entails many different assumptions and standard practices that are not incorporated in this Article. This is also true for trademark licensing. As to trademark licensing, there is the additional consideration of coverage of aspects of that industry under federal and state franchising laws

4. *Embedded Programs.* Subsection (3) excludes computer programs that are part of goods and sold or leased as such. This excludes programs such as airplane navigation or operation software, software in automobile brake systems, and the like. Issues about this type of software are governed by the law governing the transaction in the entire product (e.g., Article 2 or Article 2A).

The exclusion does not apply if the program is in goods that are merely a copy of the program (e.g., a diskette) or in a computer (e.g., embedded operating system software). Article 2B does not apply to cars, toasters, washing machines and other traditional goods. On the other hand, Article 2B does apply to copies of programs in a computer system or a computer peripheral such as a printer, scanner, or modem. Even then, Article 2B does not apply to the product, but merely to the program.

The term "computer" refers to a machine or system that has the capability of performing arithmetic, logical or processing functions on data. Clearly, the scope of the term will change as modern products become increasingly "intelligent" (i.e. reliant on information manipulation capabilities).

The issue centers on the relative coverage of this Article and Article 2 or 2A. In discussing this, however, it is important to recognize that, in the mass market, where the issues will be most significant, Article 2B principles are generally consistent with existing Article 2 and Article 2A. Often, which law applies does not alter the substantive standards.

Sub-part (C) sets out a that a court should use as to embedded computer programs within the inevitable gray areas. It applies Article 2B to the software if a primary purpose of the transaction is to provide access to the functional attributes of the program. Thus, while a television set in modern practice is increasingly driven by computer programs, it remains a television set whose purpose is to provide television program reception unless or until the system evolves into something more or different in which a primary purpose is to offer software processing capability. On the other hand, separately licensed software in a digital camera that allows the camera to be linked to a computer so that images can be transferred back and forth and manipulated is within Article 2B.

5. *Core Financial Functions.* Subsection (4) excludes core banking, payment and financial services activities. Article 2B does not cover transactions governed under other UCC law (e.g., Article 4A, Article 4). It is preempted to the extent of specific controls under federal or state banking regulation.

This is not an exclusion of banks or financial institutions per se. Modern developments in digital cash and similar systems place many companies other than traditional banks in the same situation. Regulations, such as Regulation E on funds transfer, do not apply solely to banks, but to any holder of a depository account and, depending on regulatory decisions, non-bank entities will be included (e.g., a digital account on a "smart card" for use to purchase a total of $100 of coffee from a coffee shop). However, modern banks engage in many activities identical to licensing practice and online systems clearly within Article 2B, such as Netscape, Westlaw, Home Shopping, Microsoft Network, America On-Line, and others. As the information industries converge, so too is the banking industry converging into fields identical to that of the information industries. Bank ***entry*** into these fields is regulated, but this is scope regulation, not content regulation. These activities are covered by Article 2B.

6. *Personal Services.* Subsection (5) deals with services contracts. The excluded cases involve **personal** services; the law governing employment and other personal service activities entails different default rules and business practices than apply here. The entertainment services exclusion covers both direct contracts with individuals and various structures under which a party hires services of an

individual or group through a loan contract with a nominal legal entity with whom the individual or group is employed.

The subsection does not exclude situations where automation creates a digital replacement for activities previously characterized as personal services. Also, it does not remove from this Article the various forms of software development contracts, many of which are characterized by an individual (or group) contracting to design and develop software for a client. Inclusion of these contracts in Article 2B reflects a primary early reasons for the Article since, in the absence of inclusion, courts are split on whether such contracts fall within Article 2 (sales) or common law (services). Article 2B resolves that issue by bringing the contracts into this Article.

7. *Broadcast, Movies and Cable.* Subsections (6) and (8) excludes traditional licensing in the motion picture, broadcast and cable industries. The exclusion reflects various considerations, including both the existence of a regulatory overlay (cable and broadcast) and the different nature of liability and other concerns involved. The exclusion is limited to **traditional** activities and, as with reference to financial systems, is not an exclusion of the industry. As companies move into on-line systems, software, multi-media and similar licensing, Article 2B applies.

2B-105. RELATION TO FEDERAL LAW; TRANSACTIONS SUBJECT TO OTHER STATE LAW.

(a) A provision of this article which is preempted by federal law is unenforceable to the extent of such preemption.

(b) [A contract term that violates a fundamental public policy is unenforceable to the extent that the term is invalid under that policy.]

Official Comments:

At the nccusl annual meeting commissioner perlman made a motion that it was the sense of the house that the draft state a public policy limitation on the enforceability of contract terms, with flexibility for the drafting committee to determine where and the way in which it should be expressed. the full text of the motion is reprinted below. the bracketed language in subsection (b) and notes below are a response from the reporter and chair of the drafting committee to provide a basis for discussion at the november 13-15 drafting committee meeting. also provided as a basis for discussion is a modification of section 2b-106(d) indicating that the decision is for the court as a matter of law. the original motion referred to three specific sources of public policy. the common law principle applicable under section 1-103 is not so limited. the bracketed language provided as a basis for discussion omits the specific references and the committee needs to consider whether they should be included.

(c) Pursuant to Section 1-103, principles of law and equity supplement this article. Among the laws supplementing, and not displaced by this article are trade secret laws and unfair competition laws.

(d) Except as otherwise provided in this section, in the case of a conflict between this article and a statute or regulation of this State establishing a consumer protection in effect on the effective date of this article, the conflicting statute or regulation controls.

(e) If a law of this State in effect on the effective date of this article applies to a transaction governed by this article, the following rules apply:

(1) A requirement that a term, waiver, notice, or disclaimer be in a writing is satisfied by a record.

(2) A requirement that a writing or a term be signed is satisfied by an authentication.

(3) A requirement that a term be conspicuous or the like is satisfied by a term that is conspicuous in accordance with this article.

(4) A requirement of consent or agreement to a term is satisfied by an action that manifests assent to a term in accordance with this article.

(f) Failure to comply with a statute or regulation referred to in subsection (c) has only the effect specified in the statute or regulation.

(g) A statute authorizing electronic or digital signatures in effect on the effective date of this article is not affected by this article.

Legislative* Official Comments: *Each state should review the statutes that may be affected by subsection (d) to determine whether under their fundamental policy the effect should not apply to some of those statutes. If any, the state should exclude such statutes from subsection (d).

Sources: Section 9-104(1)(a); 2A-104(1)

Definitional Cross References:

"Agreement": Section 1-201. "Authenticate:" Section 2B-102. "Conspicuous": Section 2B-102. "Consumer": Section 2B-102. "Electronic": Section 2B-102. "Information": Section 2B-102. "Informational Rights": Section 2B-102. "Notice": Section 1-201. "Record": Section 2B-102. "Rights": Section 1-201. "Signed": Section 1-201. "Term": Section 1-201. "Writing": Section 1-201.

Note to this Draft:

AT THE ANNUAL MEETING, COMMISSIONER PERLMAN MOVED AS A SENSE OF THE HOUSE WITH FLEXIBILITY FOR THE DRAFTING COMMITTEE TO DETERMINE WHERE AND THE WAY IN WHICH IT SHOULD BE EXPRESSED WITH POSSIBLE INSERTION IN SECTION 2B-110 THE ADOPTION OF A PUBLIC POLICY LIMTIATION ON CONTRACTS. THE WRITTEN MOTION WAS AS FOLLOWS:

2B-110. UNCONSCIONABLE IMPERMISSIBLE CONTRACT OR TERM.

(a) If a court as a matter of law finds the contract or any term of the contract to have been unconscionable or contrary to public policies relating to innovation, competition, and free expression at the time it was made, the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the ~~unconscionable~~ impermissible term as to avoid any unconscionable or otherwise impermissible result.

(b) When it is claimed or appears to the court that the contract or any term thereof may be unconscionable or impermissible under this section the parties shall be afforded a reasonable opportunity to present evidence as to ~~it's~~ the contract's or term's commercial setting, purpose and effect and the extent to which the contract or term resulted from the actual informed affirmative negotiations of the parties to aid the court in making the determination.

Official Comments:

1. *General Principle.* Article 2B deals solely with contract law, not intellectual property, competition, or trade regulation law. Subsections (a), (b) and (c) clarify that the Article does not displace or alter the relationship between these laws and contract law. Subsection (d) states a similar principle for consumer protection law subject to the limited electronic commerce rules contained in subsection (e).

With the transition from print to digital media, many different and potentially valuable (for users, authors, and publishers) new uses of information and informational rights have emerged and created policy and economic disputes. The difficulty of balancing fundamental rights in this new context is demonstrated by the complexity of the disputes and the fact that many remain unresolved in the U.S. and internationally. These broad policy questions are beyond the scope of contract law and this Article. As urged by a near unanimous "sense of the house" vote at the NCCUSL 1997 Annual Meeting, the approach of Article 2B has been to correspond state law to clear rules of federal law and to take no position on controversial rules whose application cannot be predicted but must await determination as a general federal policy question.

2. *Federal Law: Preemption.* Subsection (a) states a rule that applies to all state law. If federal law invalidates a state contract law or contract term in a particular setting, federal law rule controls. Subsection (a) refers to preemptive federal rules, but other doctrines grounded in First Amendment, copyright misuse and other federal law may limit enforcement of some contract terms in some cases. These are also recognized in subsection (b) which has been proposed for discussion. Defining federal policy or when federal law controls is generally not an issue of state law. State laws, including the UCC, cannot alter or create federal law.

There are many sources of federal preemption. Some stem from intellectual property law. Section 301 of the Copyright Act preempts any state law that creates rights equivalent to copyright. That rule will seldom apply to contracts since a contract deals with the relationship between parties to an agreement, while property law in the Copyright Act deals with interests good against persons with whom the property owner has not dealt. Contracts control many aspects of the commercial distribution of information. This contract law regime pre-existed Article 2B. While, federal copyright law precludes state law that creates rights equivalent to the property rights created under copyright, both as a practical and conceptual matter, copyright does not generally preclude or preempt contract law. Indeed, contracts are essential to use of property whether tangible or intangible.

However, some terms of the copyright or patent act and some established lines of judicial authority that announce specific policies pursuant to those acts, specific federal rules may invalidate conflicting contract law rules. See, e.g., **Everex Systems, Inc. v. Cadtrak Corp.,** 89 F.3d 673 (9th Cir. 1996) (transferability of a patent license); **Harris v. Emus Records Corp.,** 734 F.2d 1329 (9th Cir. 1984) (copyright license); **Rano v. Sipa Press, Inc.,** 987 F2d 580 (9th Cir. 1993) (copyright preempts state law on licenses terminable at will). In some cases, preemption may arise under the federal constitutional Supremacy Clause.

Of course, beyond intellectual property law, many other contracts or terms are subject to preemptive federal regulation. See, e.g., Regulation E, the Electronic Communications Privacy Act, the Communications Act of 1996, the Freedom of Information Act, the Food and Drug Administration Act. An enumeration of these would be impossible and ever-changing.

3. *Public Policy Invalidation.* Contract terms may be unenforceable because of preemption or because the term is unconscionable. In addition, subsection (b) acknowledges the general legal principle that, in certain circumstances, terms enforceable under contract law may be unenforceable because they are invalid under a fundamental public policy that clearly over-rides the fundamental policies that support freedom of contract and enforcing the agreements of parties. The principle in subsection is recognized in common law and the **Restatement (Second) of Contracts** ? 178. It is a supplementary legal principle incorporated under Section 1-103 and applies to all contract law and all articles of this Code. The principle is mentioned here because the scope of this article and the importance of free expression and competition policy issues regarding information make it important to reiterate basic principles.

The most common source of a fundamental policy invalidating a contract term is legislation that provides that a particular term is unenforceable. In the absence of such legislation specifically invalidating a term, the asserted fundamental policy must be clearly over-riding as compared to the fundamental policies supporting freedom of contract. The strength of any public policy when balanced against the fundamental policies that support contract enforcement may be gauged by a variety of factors, including the strength and consistency of judicial decisions defining and enforcing the policy in similar contexts, the existence of express legislative or similar statements of the policy, the extent to which the policy is recognized nationally, and the likelihood that enforcement will in fact further that policy. In all cases, however, the decision requires a balancing of the general public policy against the public policy to enforce justifiable contract expectations and the need to avoid the forfeiture that may result if a contract term is invalidated. In light of the international character of the information industries and the interests of uniformity embodied in the UCC, courts should be reluctant to rely on purely local policies to invalidate contract terms in the absence of a clear expression of such policy in a local statute.

Public policy, of course, stems from various sources. Among the sources that might be applicable to transactions within this article are policies about innovation, competition, and free expression policy. In practice, enforcing private contracts is most often consistent with the fundamentals of these areas of policy. Contract law, freedom of expression, competition and innovation policy are not only consistent, they are most often mutually supportive. Thus, a wide variety of contract terms relating to the use of information present no significant issue under public policy invalidation doctrine. For example, contract restrictions on libelous or obscene language in an on-line chat room promote interests in free expression and association. In some cases, however, a conflict exists and fundamental public policy other than the policy freedom of contract enforcement may over-ride and control.

Fundamental public policy recognizes the general ability of third parties to use information owned by others for such purposes as comment, criticism and news reporting, but it also recognizes the right of an information owner to place limitations on use and that there are many instances in which such limitations enhance innovation, dissemination of information, and competition. For example, trade secret law allows information to be transferred subject to contractual limitations on disclosure. This facilitates the exploitation and commercial application of new technology. Information policy thus seeks a balance between two competing interests: the interest of creating sufficient incentives for innovation by permitting owners to reap the returns from their innovative activities and the public interest in preserving and expanding information in the public domain in order to provide the store of knowledge on which innovation depends. Striking this balance depends on a variety of contextual factors that can only be assessed on a case by case basis with an eye to national policies. The rule recognized in subsection (b) permits courts in appropriate cases to over-ride contract terms where compelling fundamental public policy should prevail to preserve this balance, while continuing to recognize the fundamental policies that support contract and commercial markets as recognized in the [Uniform Commercial Code] and common law.

A term or contract that results from an informed private agreement between commercial parties should be presumed to be valid and a heavy burden of proof should be imposed on the party seeking to escape the terms of the agreement under subsection (b). On the other hand, this Article recognizes the commercial necessity of also enforcing mass market transactions that involve the use of standard form agreements. The terms of such forms may not be available to the licensee prior to the payment of the price and typically are not subject to affirmative negotiations. In such circumstances, courts must be more vigilant in assuring that limitations on use of the informational subject matter of the license are not invalid under fundamental public policy.

However, even in mass market transactions, limitations in a license for software or other information that prohibit the licensee from making multiple copies, or that prohibit the licensee or others from using the information for commercial purposes, or that limit the number of users authorized to access the

information, or that prohibit the modification of software or informational content without the licensor's permission would in most circumstances be enforceable.

On the other hand, terms in a mass-market license that prohibit persons from observing the visible operations or visible characteristics of software and using the observations to develop non-infringing commercial products, that prohibit quotation of limited material for education or criticism purposes, or that preclude a public library licensee from making an archival copy would ordinarily be invalid in the absence of a showing of significant commercial need. Although it deals with a statutorily created right and not a contract, the Court's discussion in **Bonito Boats, Inc. v. Thunder Craft Boats, Inc.,** 489 U.S. 141, 109 S.Ct. 971, 103 L.Ed.2d 118 (1989) indicates some of the intellectual property policy issues that might be considered.

The court's discussion in **Consumers Union v. General Signal Corp.,** 724 F.2d 1044 (1983) also indicates some of the First Amendment concerns to considered with respect to such published material. The fundamental policy lies in encouraging and sustaining discussion and appropriate use of information placed in public contexts and is reflected in property law concepts of fair use and fundamental ideas of free expression. However, it is quite clear that the federal policy on dissemination of information co-exists with the ability of parties to make confidential disclosures and deal with information that is to be kept secret.

In balancing freedom of contract against other strong fundamental policies expressed in statutes, the court should take into account this Article and the [Uniform Commercial Code] express public policy regarding general contract law themes such as formation of contracts, creation and disclaimer of warranties, measurement and limitation of damages, basic contractual obligations, contractual background rules, the effect of contractual choice, risk of loss, priority of rights, and the like. While these policies may be over-ridden by statutes, it is inappropriate for a court to reverse or revise the statutory decisions on these issues based merely on its general belief about what should be appropriate policy on general contract law issues.

Under the general principle in subsection (b), courts also may look to federal copyright and patent laws for guidance on what types of limitations on the rights of owners of information ordinarily seem appropriate, recognizing, however, that private parties may have sound commercial reasons for contracting for limitations on use and that enforcing private ordering arrangements in itself reflects a fundamental public policy enacted throughout [the Uniform Commercial Code] and common law.

In part because of the transformations caused by digital information, many areas of public information policy are in flux and subject to extensive debate. One debate deals with when a party may reverse engineer a product to discover and use technology for competitive purposes. U.S. law holds that the buyer of a product sold on an unrestricted basis in an open market may disassemble it to obtain insights into the operations of the product and its technology.

Even in mass markets, however, the public policy balance is less clear when reverse engineering involves acts that may infringe exclusive property rights of the information rights owner with respect to digital products. Reverse engineering to examine software code may require reproducing (copying) the code to examine it; this may violate the copyright owner's exclusive right to make copies of its work, an issue that does not arise in reverse engineering ordinary goods. Several cases, not involving license restrictions, hold that making intermediate copies of copyrighted technology for "reverse engineering" and understanding technology constitutes fair use in some circumstances associated with, among other things, the need for the information to achieve interoperability and the extent of the copying involved.

See **Sega Enterprises Ltd. v. Accolade, Inc.**, 977 F2d 1510 (9th Cir. 1992); **Atari Games Corp. v. Nintendo of Am., Inc.,** 975 F2d 832 (Fed. Cir. 1992). The scope of fair use here is not clear and it is also unclear how a contract term alters the analysis. Doctrines other than fair use may also apply. For example, an anti- reverse-engineering clause that in effect attempts to monopolize a different product market may constitute copyright misuse under U.S. law in some cases.

The issue has international dimensions. A European Union Directive provides that reverse engineering is not copyright infringement and cannot be barred by contract if it is necessary in order to obtain information to make interoperable products and that information is not otherwise available. **Directive 91/250 on Legal Protection of Computer Programs**, OJ 1991 L122/42 (May 14, 1991). Proposed legislation is pending in Congress that may establish by statute a limited right to reverse engineer. Article 2B does not address or alter this area of public policy which is properly left for resolution in other venues.

4. *State Law: Unfair Competition and Trade Secrecy.* Subsection (c) also restates a principle in Section 1-103 that this Article is supplemented by state law. It specifically refers to unfair competition and trade secret law. For example, these state laws may limit the term during which a contract restriction on competition can be enforced. This Article does not alter that rule. Beside being expressly so stated

here, that principle is also incorporated in the definition of "contractual use restrictions", which enforces such terms only to the extent enforceable under other law.

5. *State Law: Consumer Law.* Article 2B does not generally alter state consumer protection statutes in effect on the effective date of enactment of Article 2B. This rule recognizes the role of independent and potentially divergent state consumer protection statutes as a complement to the UCC. Consistent with the stated purpose of the UCC, Article 2B deals with general contract law and commercial contract law principles. It does not promulgate a consumer protection code, although it does contain certain innovative consumer protections.

Historically, consumer protection issues have been resolved on a state-by-state basis. These statutes reflect extensive policy review about the relationship between protection and contract freedom in each state. Article 2B, as a general commercial statute, does not override these judgments. With the exception of the electronic commerce rules in subsection (e), a state's consumer protection statutes or regulations trump the general contract law of this Article. Thus, for example, a consumer protection statute that mandates disclosure of local service outlets or the location of the licensor's main business office in a consumer transaction is not affected by Article 2B.

In addition, Article 2B contains a number of consumer protection rules for consumer transactions within this Article or under the more general reference to mass-market licenses, a category that includes all consumer transactions. These rules augment existing consumer protection statutes and the existing protections control to the extent of any conflict. A conflict, for this purpose, would occur if an Article 2B rule provides less protection for the consumer than does the consumer protection statute. The provisions of this Article that provide additional consumer protections include: 2B-107 (choice of law); 2B-118 (electronic error); 2B-208 (limit on mass market license; right to refund); 2B-303 (limit on no-oral modification clause); 2B-304 (limit on modification of continuing contract); 2B-406 (warranty disclaimer); 2B-409 (third-party beneficiary); 2B-609 (perfect tender); 2B-619 (limit on hell and high water clauses); 2B-703 (exclusion of personal injury claim).

6. *State Law: Electronic Commerce Issues.* Subsection (e) is an electronic commerce provision of great significance for Internet and similar transactions. The principle is that Article 2B overrides contrary state law requiring a "writing", a "signature" or a "conspicuous" term to the extent that it provides electronic commerce rules on issues such as authentication and the like. This premise, of course, operates only within the scope of this Article. The rule is necessary to enable the modernization and uniformity themes developed in this Article.

There are thousands of relevant statutes. For transactions governed by Article 2B, the rules of this Article ordinarily supplant the other law as to contractual issues in full and the express preemption stated in this section is not necessary. That is not true for consumer transactions. In the consumer area, the four stated themes reflect a limited approach that balances the modernization theme and the desire not to alter existing protection. The limited approach adopted here contrasts to non-uniform digital signature statutes enacted in several states which replace or amend all signature and writing requirements, including consumer statutes.

The balance adopted here preserves the important policies (e.g., the principle of general non-reversal of consumer statutes), but extends the innovations in electronic contracting.

A number of states have adopted electronic or digital signature statutes. Digital signature statutes that predate Article 2B are not repealed or affected by Article 2B. In many cases, these statutes provide for broader preemptive effect than is contemplated in this Section. On other points, most often, no conflict exists. The statutes create a procedure consistent with and parallel the more general Article 2B themes.

7. *State Law: Computer Viruses.* Article 2B does not deal with computer viruses and does not alter existing criminal or tort law on that subject. In general, a "virus" consists of computer code put into a software or other system with the intended effect of disrupting the system or altering or destroying information in that system. Law in most states and federal law makes the knowing or intentional introduction of a computer virus a criminal act. See, e.g., Raymond Nimmer, Information Law ¶ 9.04 (1997).

The fact that most state law and enforcement concerning viruses falls under criminal law correctly suggests that most virus risks result from acts of third parties not in a contractual relationship with the victim. Acts that cause loss through the creation or distribution of a computer virus might also give rise to liability in tort in appropriate cases under concepts of trespass or negligence. While few civil actions have been brought, the liability of a wrongdoer for actions that harm a third party involve issues other than under contract law.

As to contractual issues, virus problems typically arise between two, ordinarily innocent, contracting parties. In licensing law under Article 2B, they are handled as is any other type of contract risk. A virus may cause the information to fail to perform within contract requirements. Any remedy in contract is

determined by the general rules of this Article. The remedy under tort law or the sanction under criminal law are determined by the rules of those particular bodies of law.

2B-106. VARIATION BY AGREEMENT; RULES OF CONSTRUCTION; QUESTIONS DETERMINED BY COURT.

(a) Except as otherwise expressly provided in this article or in Article 1-102(3), the effect of any provision of this article, including allocation of risk or imposition of a burden, may be varied by agreement of the parties.

(b) Except to the extent provided in the following listed sections, an agreement may not vary:

(1) the limitations on choice of law in Section 2B-107(a);

(2) the limitations on choice of forum in Section 2B-108;

(3) the provisions concerning an unconscionable contract or term in Sections 2B-110, 2B-208(a), 2B-626(c), and 2B-703(d);

(4) the provisions for manifest assent and opportunity to review in Sections 2B-111 and 2B-112;

(5) the provisions on electronic errors in Section 2B-118;

(6) the limitations on enforceability in Section 2B-201;

(7) the provisions on mass-market licenses in Section 2B-208;

(8) the requirements as to consumers in Section 2B-303(b);

(9) the limitations on disclaimer of warranties in Section 2B-406;

(10) the limitations on liquidated damages in Section 2B-704(a);

(11) the restrictions on the statute of limitations in Section 2B-705(a); or

(12) the limitations on self-help repossession in Section 2B-715(b).

(c) In applying this article, the following rules of interpretation apply:

(1) The use of mandatory language or the absence of a phrase such as "unless otherwise agreed" in a provision of this article does not preclude the parties from varying the effect of the provision by agreement.

(2) The fact that a provision of this article states a condition for a result does not of itself mean that the absence of that condition yields a different result.

(3) Unless this article requires a term to be conspicuous or negotiated or that there be manifest assent or express agreement to the term, or makes a term that fails to meet any of these requirements unenforceable, such a requirement is not a condition to enforceability of the term.

(d) Whether a term is conspicuous or is excluded under Sections [2B-105(a) or (b) or] 2B-208(a) is a question to be determined by the court.

Uniform Law Source: None.

Definitional Cross References:

"Agreement". Section 1-201. "Conspicuous". Section 2B-102. "Contract". Section 1-201. "Court". Section 2B-102. "Electronic": Section 2B-102. "Term". Section 1-201. "Transfer". Section 2B-102.

Official Comments:

1. *Basic Principle.* Article 2B follows the basic commercial law principle of contractual freedom. Contract choices control unless there are tangible over-riding policy considerations that mandate restraints on contract choice, such as in the doctrine that contract terms not be unconscionable. Subsection (b) brings together the sections in this Article where contract choice does not control.

The dominance of "agreement" as altering the effect of provisions of this Article does not require a formal writing or express terms. It may occur as the result of course of dealing, trade use or other circumstances; the "agreement" encompasses the entire bargain of the parties in fact. See Section 1-201.

2. *Drafting Style.* The dominance of agreement over statutory rules characterizes all U.C.C. transactional articles. It is especially important to state the principle here. Article 2B was drafted without use of the phrase "unless otherwise agreed" and frequently use mandatory language, such as "shall" or "must." This does not change the basic principle that the contract controls. Article 2B provisions can be

altered by agreement unless otherwise indicated. This section rejects decisions such as *Suburban Trust and Savings Bank v. The University of Delaware,* 910 F. Supp. 1009 (D. Del. 1995).

3. *Rules of Construction.* Subsection (c) deals with several interpretation concerns. Subsection (c)(2) resolves questions about the existence of a so-called negative pregnant in the rules in this Article. Thus, if a section states that "If the originator of a message requests acknowledgment, then the following rules apply: ---" that does not indicate what rules apply in the absence of that request; in itself, it does not bar a court from adopting some or all of the same rules in the absence of a request, but merely states the affirmative proposition. If a more exclusionary result is intended, it is made express. Similarly, subsection (c)(3) states the premise that, for purposes of this Article, requirements of conspicuousness, assent or the like exist only when expressly imposed with respect to a particular term.

4. *Issues as a Matter for the Court.* Subsection (d) follows current law. Other issues in this Article are also questions for the court and are so indicated in the relevant section or applicable case law or procedural rules.

2B-107. CHOICE OF LAW.

(a) The parties in their agreement may choose the applicable law. In a consumer transaction, however, the choice is not enforceable to the extent it varies a rule that may not be varied by agreement under the law of the jurisdiction whose law would apply in the absence of the agreement as determined under subsections (b) and (c).

(b) In the absence of an enforceable choice-of-law term, the following rules apply:

(1) An access contract or a contract providing for electronic delivery of a copy is governed by the law of the jurisdiction in which the licensor is located when the agreement is made.

(2) A consumer transaction that requires delivery of a copy on a physical medium to the consumer is governed by the law of the jurisdiction in which the copy is delivered or, in the event of nondelivery, the jurisdiction in which delivery was agreed to have occurred.

(3) In all other cases, the contract is governed by the law of the jurisdiction with the most significant relationship to the contracttransaction.

(c) In cases governed by subsection (b), if the jurisdiction whose law governs under subsection

(b) is outside the United States, the law of that jurisdiction governs only if it provides substantially similar protections and rights to a party not located in that jurisdiction as are provided under this article. Otherwise, the law of the jurisdiction in the United States which has the most significant relationship to the transaction governs.

(d) For purposes of this section, a party is located at its place of business if it has one place of business, at its chief executive office if it has more than one place of business, or at its place of incorporation or primary registration if it does not have a physical place of business. Otherwise, a party is located at its primary residence.

Uniform Law Source: Restatement (Second) of Conflicts 188; U.C.C. 1-105. Revised.

Definitional Cross Reference:

"Access contract": Section 2B-102. "Agreement": Section 1-201. "Consumer": Section 2B-102. "Consumer transaction": Section 2B-102. "Contract": Section 1-201. "Copy": Section 2B-102. "Delivery": Section 2B-102. "Electronic": Section 2B-102. "Licensor": Section 2B-201. "Party": Section 1-201. "Rights": Section 1-201.

Official Comments:

1. *Contractual Choice of Law: General Rule.* This section addresses two questions. The first concerns the enforceability of contract terms choosing the applicable law. Choice of law clauses are routine in commercial licenses and are important in commercial deals. The information economy accentuates that importance through expanded communications capabilities and, with respect to transactions in information, the fact that remote parties frequently engage in contract formation **and** performance through remote systems spanning two or more jurisdictions and not dependent on the physical location of either party or of the information itself.

Article 2B adopts a contract choice position validating choice of law agreements in commercial transactions. A rule that validates choice of law terms states an important policy where an increasing number of modern information transactions occur in cyberspace, rather than in fixed locations. Because many information transactions are not related to tangible locations, in the absence of the right to choose applicable law, even the smallest business entity on the Internet is subject to the law of all fifty states

and all countries in the world. That would have long term adverse effects on electronic commerce. This Section is one of the most important contributions of Article 2B to electronic commerce.

The Restatement allows contract terms to govern in any case where the issue could be resolved by contract. Common law generally enforces contractual choice of law in transactions in information. **See Finch v. Hughes Aircraft Co.,** 57 Md. App. 190, 469 A.2d 867, 887, cert den 298 Md. 310, 469 A.2d 864 (1984), reh. den. 471 U.S. 1049 (1985); **Medtronic Inc. v. Janss**, 729 F.2d 1395 (11th Cir. 1984); **Universal Gym Equipment, Inc. v. Atlantic Health & Fitness Products**, 229 U.S.P.Q. 335 (D. Md. 1985); **Northeast Data Sys., Inc. v. McDonnell Douglas Computer Sys. Co.,** 986 F.2d 607 (1st Cir. 1993). The major exception occurs if the choice contradicts a fundamental, mandatory policy of the state that would otherwise have its law apply; the cases applying this theory are typically consumer protection cases. Under the **Restatement, even** if contract might not otherwise change the rule, the contract choice is presumed valid, subject to exceptions. **Restatement (Second) of Conflict of Laws** 187 (may be invalid if not resolvable by contract **and** either there was no "reasonable basis" for the choice of that state's law, or "application of the law of the chosen state would be contrary to a fundamental policy of a state which has a materially greater interest than the chosen state in the determination of the particular issue.").

2. *Contract Choice: Consumer Contracts.* Despite strong reasons for enforcing all contract choices, Article 2B takes the position that the contract cannot override mandatory consumer protections that otherwise apply. A mandatory rule is a rule that, under applicable law, cannot be altered by agreement. Such rules exist in most states, but their content varies widely. The reference to consumer protections includes rules under both the UCC and non-UCC law.

3. *Default rule: no contract provision.* The second issue in this Section involves choice of law in the absence of contract terms and is covered in subsection (b). The purpose of stating choice of law rules is to enhance certainty against which the parties can bargain if they so choose and a basis for planning transactions with a reasonable understanding of the applicable risk. A leading Treatise comments: "[C]hoice-of-law theory today is in considerable disarray - and has been for some time. [It] is marked by eclecticism and even eccentricity. No consensus exists among scholars.... The disarray in the courts may be worse. Four or five theories are in vogue among the various states, with many decisions using - openly or covertly - more than one theory." **William Richman & William Reynolds, Understanding Conflict of Laws** 241 (2d ed. 1992).

Article 2B adopts the modern **Restatement (Second) of Conflicts** but provides two specific, commercially useful and discernable rules that supersede the general concept.

4. *Default rule: Internet Transactions.* The most important rule is in subsection (b)(1). It deals with electronic transactional environments and creates a presumptive choice of law based on the location of the licensor. Where an on-line vendor automatically provides direct access to the world through Internet, any other formulation would require the vendor to comply with the law of fifty states and 170 countries since it will often not be clear where the information is being sent.

In this section, the licensor's location refers to its chief executive office, rather than the location of the computer that contains or provides the information. Unlike other choices (such as the licensee's location, the location of the data), this choice provides a single, routinely identifiable background for commerce.

5. *Default Rule: Consumer Deliverables.* Subsection (b)(2) creates a consumer rule for cases of physical delivery of tangible copies (not involving online contracts). The rule focuses on the location where the copy is received. That location would typically be chosen under any choice of law regime, but this section makes the choice clear. Thus, for example, a consumer acquiring software in Chicago will be subject to the law of Illinois in the absence of contract terms. That rule is consistent with concerns about the "place of performance" and similar considerations under current law. It is also followed in many European consumer protection rules relating to contract choice of law involving sales of goods and services. This rule deals with situations in which the licensor will know where delivery will occur because it delivers a physical copy and is not engaged in an electronic communication. This allows electronic transactions to be governed by a choice of law rule that enables commercial decision-making based on an identifiable body of law and does not impose costs on the transaction by requiring that the electronic vendor determine what physical location corresponds to an electronic location.

The Section, of course, only deals with contract issues. It does not affect tax, copyright, or similar concerns. Compare **Quill Corp. v. North Dakota**, 504 U.S. 298 (1992) (tax nexus); **Allarcom Pay Television, Ltd. v. General Instrument Corp.,** 69 F.3d 381 (9th Cir. 1995)(copyright).

6. *Default Rule: Restatement Concept.* The residual rule adopts the **Restatement (Second)** test and cases interpreting it. The **Restatement (Second) of Conflicts** uses a "most significant relationship" standard to be judged by considering a variety of factors that include: (a) the place of contracting, (b) the place of negotiation of the contract, (c) the place of performance, (d) the location of the subject

matter of the contract, and (e) the domicile, residence, nationality, place of incorporation and place of business of the parties. (f) the needs of the interstate and international systems, (g) the relevant policies of the forum, (h) the relevant policies of other interested states and the relative interests of those states in the determination of the particular issue, (i) the protection of justified expectations, (j) the basic policies underlying the particular field of law, (k) certainty, predictability and uniformity of result, and (l) ease in the determination and application of the law to be applied. **Restatement (Second) 6- 188.**

7. *Default Rule: Foreign Jurisdictions.* Subsection (c) provides a rule in cases of foreign choices of law where the effect of using the applicable rule would locate the choice in a substantively inappropriate location. This is especially important in context of the global Internet context. The subsection does not address which party has the burden to establish the inadequacy or adequacy of the foreign state's law.

2B-108. CONTRACTUAL CHOICE OF FORUM.

(a) The parties in their agreement may choose an exclusive judicial forum unless the choice is unreasonable and unjust.

(b) A choice-of-forum term is not exclusive unless the agreement expressly provides that the chosen forum is exclusive.

Definitional Cross References:

"Agreement": Section 1-202. "Party": Section 1-201. "Term": Section 1-201.

Official Comments:

1. *General Rule.* This section deals with choice of an exclusive judicial forum. It does not cover contract terms that **permit** litigation to be brought in a designated jurisdiction, but do not require that result. Permissive forum clauses are governed by general contract law. The Section deals only with judicial forum choices. Choices by contract of arbitration or other non-judicial forums are governed by other law and the provisions of this Section do not alter that pre-existing law.

This Section adopts the modern view of the enforceability of choice of forum clauses first stated in **Bremen v. Zapata Offshore Co.,** 407 U.S. 1, 10 (1972) (choice of forum clauses are "prima facie valid"). Subsequent case law, both in the United States Supreme Court and in state courts, increasingly conforms to the presumptive enforceability of choice of forum clauses, whether in customized agreements or in standard forms.

2. *Fairness Limitation.* Concerns about fairness and notice may limit enforcement of the clause. This Section adopts the approach to such questions established in **Breman** and followed in most modern decisions. **Breman** indicated that the contract term could be rejected if it was "unreasonable and unjust." See **Perkins v. CCH Computax, Inc.,** 106 N.C. App. 210, 415 S.E.2d 755 (1992); **Lauro Lines v. Chasser**, 490 U.S. 495 (1989); **Sterling Forest Assocs., Ltd. v. Barnett-Range Corp.,** 840 F.2d 249 (4th Cir. 1988).

This section adopts the limiting language that has become the dominant theme in the case law: "unjust and unreasonable." Many courts suggest that choice of forum clauses are presumptively enforceable unless it causes clearly unfair results. The intent in this section is to conform to those cases in reference to what limits on choice of forum are appropriate.

The section precludes clauses that choose an exclusive forum solely for the purpose of preventing a other party from being able to contest disputes that may arise under the transaction. Such choices may be **unreasonable** and their impact is **unjust.** On the other hand, clauses that serve valid commercial purposes are not invalidated simply because they adversely effect a party

3. *Internet and Cyberspace.* The importance of choice of forum provisions is heightened in transactions in cyberspace as reflected by a line of contentious personal jurisdiction rulings in the last several years. The cases on personal jurisdiction in this environment are split between those requiring active involvement in a state for jurisdiction from Internet activity and those that hold a passive Internet use is sufficient to for jurisdiction in all states to which Internet reaches. In this context, the importance of being able to delineate by contract the scope of exposure is commercially crucial. This was emphasized in a 1997 White House Report on Global Electronic Commerce.

In Internet transactions, choice of forum is ordinarily enforceable. The Supreme Court decision in **Carnival Cruise Lines, Inc. v. Shute**, 111 S.Ct. 1522 (1991) has relevance to Internet contracts:

> Nevertheless, including a reasonable forum clause in such a form well may be permissible for several reasons. Because it is not unlikely that a mishap in a cruise could subject a cruise line to litigation in several different fora, the line has a special interest in limiting such fora. Moreover, a clause establishing [the forum] has the salutary effect of dispelling confusion as to where suits may be brought.... Furthermore, it is likely that passengers purchasing tickets containing a forum clause ... benefit in the form of reduced fares reflecting the savings that the cruise line enjoys...

In an Internet transaction, the context suggests that choice of forum will often be justified on the basis of the international risk that would otherwise exist and, certainly, choice of forum at a party's location is reasonable.

SECTION 2B-109. BREACH OF CONTRACT; MATERIAL BREACH.

(a) Whether a party is in breach of contract is determined by the contract. In the absence of a term defining breach, a breach occurs if a party fails to perform an obligation in a timely manner, repudiates a contract, or exceeds a contractual use restriction. A breach of contract, whether or not material, entitles the aggrieved party to its remedies.

(b) A breach of contract is a material breach if:

(1) the contact so provides;

(2) the breach is a failure to perform an agreed term that is an essential element of the agreement; or

(3) the circumstances, including the language of the agreement, the reasonable expectations of the parties, the standards and practices of the trade or industry, or the character of the breach, indicate that:

(A) the breach caused or is likely to cause substantial harm to the aggrieved party, such as costs or losses that significantly exceed the contract value; or

(B) the breach substantially deprived or is likely substantially to deprive the aggrieved party of a substantial benefit it reasonably expected under the contract.

(c) A nonmaterial breach of contract is material if the cumulative effect of nonmaterial breaches is material.

Uniform Law Source: Restatement (Second) Contracts § 241.

Definitional Cross References:

"Aggrieved party": Section 1-201. "Agreement": Section 1-201. "Contract": Section 1-201. "Contractual use restriction": Section 2B-102. "Party": Section 1-201. "Term": Section 1-201. "Value": Section 1-201.

Official Comments:

1. *Nature of a Breach.* A party must conform to its contract. A breach of contract occurs whenever a party acts or fails to act in a manner required by the contract. Encompassed in this term are failures to make timely performance, breach of warranty, late delivery, repudiation, non-delivery, and exceeding contractual limitations, etc. What is and is not a breach is determined by the contract and, in the absence of contract terms, by applicable law, including this Article.

2. *Breach Related to What Remedies Apply.* For purposes of remedies for either party, Article 2B distinguishes between immaterial and material breaches. A similar distinction exists in Article 2 and Article 2A except for acceptance or rejection of a single delivery of a product. The concept also corresponds to common law and the **Restatement (Second) of Contracts**. A similar standard exists in international law. See **Convention on the International Sale of Goods** (CISG) Art. 25; **UNIDROIT Principles of International Commercial Law** art. 7.3.1.

If one party fails to conform to the contract, the aggrieved party is entitled to remedies for breach. The aggrieved party's right to cancel the contract and refuse to perform its further obligations, however, hinges on whether the breach was material. For immaterial breaches, the remedy is an action for damages. If the breach is material, the party may cancel. See Section 2B-601; **Restatement (Second) of Contracts** 237. Under Article 2B, as in Article 2, an intermediate remedy lies in the right of a party whose expectations of future performance are reasonably impaired by the other's acts or words, to suspend performance and demand adequate assurance of future performance by the other party.

The basic policy is that, while parties are entitled to the contract performance for which they bargained, some breaches are sufficiently immaterial that they do not justify forfeiture of the entire bargain. The concept rests on the common law belief that it is better to preserve a contract despite minor problems and the related belief that allowing one party to cancel for minor defects may cause unwarranted forfeiture and encourage unfair opportunism. For example, a one day delay in payment may or may not be material. A failure to fully meet general, advertised claims of handling 10,000 files may not be material where the licensee's needs never exceed 4,000 if the system handles 9,999 and the contract did not expressly require 10,000 files

Materiality relates to the aggrieved party's perspective and the benefits it expected from full performance of the contract.

3. *Contract Terms.* As in common law, materiality hinges on the terms of the contract. The contract can define what is material in three ways. The first two are (1) expressly providing a remedy for a particular breach (e.g., failure to do "X" permits cancellation) or (2) expressly defining a particular breach per se material. In either case, there is no reason to ignore what the parties have stated to be important to their bargain. The third involves what, under common law, is described as "express conditions." These are express contract terms conformance to which is a precondition to the performance of the other party. Here, the express agreement conditions the remedy.

Illustration 1. In a development contract, the parties agree that the final product must meet 10 specifications before it is acceptable. One condition provides for operation at "no less than 150,000 rev. per second." The product fails to meet that standard, falling short by a relatively small amount. Meeting that conditions was an express standard; failure to perform is justifies refusal of the product.

Illustration 2. In a contract for a database for use as a mailing list no specific delivery date is specified. The product is delivered one day later than expected. Whether the breach is material hinges on the effect of the delay on the value of the contract.

4. *What constitutes a material breach?* A statute cannot define materiality in detail any more than one can define concepts such as negligence, reasonable care, merchantability, or the like. The key lies in defining an appropriate reference point. Subsection (b) emphasizes two elements: contract terms and the extent to which breach causes significant harm to the aggrieved party. These are not exclusive. The standards in this Section should be interpreted in light of common law and Restatement principles. See **Rano v. Sipa Press**, 987 F.2d 580 (9th Cir. 1993); **Otto Preminger Films, Ltd. v. Quintex Entertainment, Ltd.,** 950 F.2d 1492 (9th Cir. 1991) ("breach ... is material if it is so substantial as to defeat the purpose of the transaction or so severe as to justify the other party's suspension of performance").

The **Restatement (Second) of Contracts** lists five significant circumstances: 1) the extent to which the injured party will be deprived of the benefit he or she reasonably expected; 2) the extent to which the injured party can be adequately compensated for the benefit of which he will be deprived; 3) the extent to which the party failing to perform or to offer to perform will suffer forfeiture; 4) the likelihood that the party failing to perform or to offer to perform will cure the failure, taking into account all the circumstances, including any reasonable assurances; and 5) the extent to which the behavior of the party failing to perform or to offer to perform comports with standards of good faith and fair dealing. **Restatement (Second) of Contracts** 241 (1981).

2B-110. UNCONSCIONABLE CONTRACT OR TERM.

(a) If a court as a matter of law finds the contract or any term of the contract to have been unconscionable at the time it was made, the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable term, or it may so limit the application of any unconscionable term as to avoid any unconscionable result.

(b) When it is claimed or appears to the court that the contract or any term thereof may be unconscionable the parties shall be afforded a reasonable opportunity to present evidence as to its commercial setting, purpose and effect to aid the court in making the determination.

Uniform Law Source: Section 2-302; 2A-108. Conforms to 2-302.

Definitional Cross References:

"Contract": Section 1-201. "Court": Section 2B-102. "Term": Section 1-201.

Official Comments:

1. *Basic Policy.* This section adopts the Article 2 doctrine that allows courts to invalidate unconscionable contracts or terms. The basic policy is to prevent oppression and unfair surprise and not to disturb allocation of risks because of superior bargaining power. Extreme imbalance in bargaining power is a factor in some unconscionability analyses where the term objected to reflects an unreasonable and oppressive treatment of the other party without giving that party fair notice of the term. A bargain is not unconscionable, however, merely because the parties to it are unequal in bargaining position, nor even because the inequality results in an allocation of risks to the weaker party.

2. *Methods of determination.* Determination of whether a clause or a contract is unconscionable must be made in light of the setting, purpose and effect of the contract or term. It is appropriate for a court to consider improprieties in the contracting process when that inquiry is accompanied by consideration of the adverse effects of particular contractual terms. Gross inequality of bargaining power, together with terms unreasonably favorable to the stronger party, may indicate that the transaction involved elements of deception or unfair surprise. In determining whether a contract term is unconscionable, a court should consider: whether the contract is an adhesion contract, the extent to which the party had an

opportunity to review the term, whether the term is inconsistent with ordinary practices for the type of contract, the extent to which the clause serves a valid commercial purpose, whether the term vitiates the dominant purpose of the transaction, and other factors.

3. *Bizarre and oppressive terms.* Assent to a standard form generally constitutes assent to all of its terms under traditional contract law concepts and this Article. Unconscionability doctrine allows courts to monitor and limit application of that principle in a way that avoids binding the assenting party to unknown terms that are bizarre and unfairly oppressive. A term is bizarre if it is strikingly out of the ordinary or highly eccentric for the type of transaction involved. Such terms, when oppressive, are commonly of a nature that the person proposing the form should know the term would cause an assenting party to refuse the contract if the term were made known to it and that the term was not known by that party. Clauses of this type are clearly outside the expectations of ordinary parties. In an anonymous mass market setting, this standard must be measured in terms of the ordinary, anticipated transferee for the particular type of information and what has actually been called to the other party's attention. The prior discussion and negotiations of the parties establish the framework for the transaction. Terms that are bizarre and oppressive, that eviscerate non-standard terms explicitly agreed to, or that eliminate the dominant purpose of the transaction may support an inference that a failure of the contracting process including a lack of opportunity to learn of the term produced terms which should be corrected under unconscionability doctrine.

4. *Electronic commerce.* This article confirms the enforceability of automated contracting practices involving "electronic agents." In some cases, however, automation may produce unexpected results because of errors in program, problems in communication, technological "bugs", or other unforeseen circumstances. When this occurs, common law concepts of mistake apply, as do the provisions of Section 2B-118. In addition, unconscionability doctrine may be used to prevent oppressive results caused by the breakdown in the contracting process. While automated transactions are a new setting for this doctrine, the safeguards it supplies are important for this type of commerce.

5. *Remedies.* The court, in its discretion, may refuse to enforce the contract as a whole if it is permeated by the unconscionability, or it may strike any single clause or group of clauses which are so tainted or which are contrary to the essential purpose of the agreement, or it may simply limit unconscionable clauses so as to avoid unconscionable results.

6. *Decision of the court.* Applying standards of unconscionability is a decision to be made by the court. Subsection (2) makes clear that the court may hear evidence on the question, but the commercial evidence is for the court's consideration, not the jury's. Only the agreement which results from the court's action on these matters is submitted to the general trier of facts.

2B-111. MANIFESTING ASSENT.

(a) A person or electronic agent manifests assent to a record or term in a record if the person, acting with knowledge of, or after having an opportunity to review the record or term, or the electronic agent, after having had an opportunity to review:

(1) authenticates the record or term; ~~or~~

(2) **in the case of conduct or statements of** a person**, the person intends to** engage in **the** conduct **or make the statement and knows or has reason to know that the other party may infer from the conduct or statement that the person assents to the record or term; or**

(3) **in the case of operations of an electronic agent, the electronic agent** engages in ~~affirmative conduct or~~ operations that ~~the record conspicuously provides, or~~ the circumstances ~~including the terms of the record~~ clearly indicate~~, will~~ constitute acceptance~~, and the person or electronic agent had an opportunity to decline to engage in the conduct or operations~~.

(b) ~~Mere retention of information, informational rights, or a record without objection is not a manifestation of assent.~~

~~(c)~~ If this article or other law requires assent to a particular term, a person or electronic agent does not manifest assent to that term unless it had an opportunity to review the term and the manifestation of assent relates specifically to the term.

(c~~d~~) Conduct or operations manifesting ~~A manifestation of~~ assent may be proved in any manner, including a showing that a procedure existed by which a person or an electronic agent must have engaged in the conduct or operations ~~that manifested assent to the record or term~~ in order to proceed with ~~further in~~ the use it made of the information or informational rights. **Proof of assent depends on the circumstances. Compliance with subsection (a)(2) is established by conduct that affirms assent and subsequent conduct that electronically reaffirms assent.]**

the bracketed provision was suggested by the chair of the committee and the reporter and was made available to the committee of the whole at the nccusl annual meeting.

the suggestion received favorable comments and is proposed for further consideration at the drafting committee meeting. the bracketed provision has been slightly modified in response to comments at the annual meeting. the proposed change in subsection (a) revises the basic standard of assent to correspond to **restatement (2d) of contracts** on assent by conduct adopting the language of that **restatement** section essentially verbatim.

Uniform Law Source: Restatement (Second) of Contracts ? 19..

Definitional Cross References.

"Authenticate". Section 2B-102. "Electronic agent". Section 2B-102. "Information". Section 2B-102. "Informational Rights": Section 2B-102. "Record". Section 2B-102. "Term". Section 1-201.

Official Comments:

1. *Manifestation of assent.* The concept of manifesting assent has several roles in contract law. The two primary roles respectively treat manifested assent as one way by which a contractual relationship is accepted by a party and as a standard to determine when a party adopts the terms of a record to define the contractual relationship. Often, of course, the same act both adopts the terms of a record and constitutes agreement to the relationship itself. In addition to these uses of the concept, in some cases, this Article requires manifesting assent **to a term** to establish the enforceability of the **term**.

Manifesting assent does not require a signature, any specific type of language or conduct, or any formalities. It can be shown by an authentication, by any conduct including use or other performance with respect to the subject matter, or by words. The breadth of the concept is especially important in modern commerce in which various formats and methods are used to establish contractual relationships, electronically or otherwise.

2. *Three analyses.* Determining whether a person manifested assent to a record under this article entails three analyses. First, the person must have had knowledge of the record or term or have had an opportunity to review it. Opportunity to review requires that the record be made available in a manner that ought to call it to the attention of a reasonable person. See Section 2B-112. Second, assuming an opportunity to review, the person must authenticate the record or term, orally express assent, or intentionally engage in conduct with reason to know that in the circumstances the conduct indicates assent.

Authenticating a record requires executing or adopting a symbol or processing the record with intent that the symbol or processing authenticate the record. See Section 2B-102. Conduct manifests assent if the party intentionally engaged in the conduct and with knowledge or reason to know that the conduct would create an inference of assent. Third, the conduct or authentication must be attributable to the person to be bound. General agency law and Section 2B-116 provide the standards for attribution.

3. *Assent by conduct.* Analysis of the overall circumstances determines whether the party intended the conduct and whether this occurred in context of knowledge or reason to know that the conduct would be treated as assent to the record or term. The issue does not involve subjective intent or purposes of the assenting party, but whether there was an act that was intentionally engaged in and whether the acting party had reason to know the inference of assent that would be drawn from that act.

In making this determination, a court should consider the nature of the conduct, whether the context, including any language on a package, a container or in a record, clearly indicates what actions indicate assent, whether the actor could decline to engage in the conduct and return the information, what information was communicated to the actor before the conduct occurred, whether the conduct resulted in access to and use of information clearly provided subject to contract terms, what are the ordinary expectations of other persons in similar contexts, what are the standards and practices of the business, trade or industry, and all other relevant factors.

No particular type of conduct or formality is required. The policy underlying this concept recognizes the wide range of behavior and interactions that in modern commerce establish a contractual relationship between parties and the terms of that relationship. However, subsection (d) makes clear that if the assenting party has an opportunity to reconfirm or deny assent before proceeding to further use the information establishes the conduct establishes assent.

In many cases, of course, a single indication of assent by an electronic or another act such as by opening a container or commencing to use information suffices if it occurs under circumstances giving the actor reason to know that this signifies assent. On the other hand, an act that does not bear a clear relationship to assent to a contract or a record would fail under the general standard of "reason to know." Similarly, acts that occur in context of a mutual reservation of the right to defer agreement do not establish assent to a contract that neither party intended.

Illustration 1: The registration screen for NYT Online prominently states: "Please read the license. It contains important terms about your use and our obligations with respect to the information. Click here to review the **License.** If you agree to the license, indicate your agreement by clicking the "I agree" button. If you do not agree to the License, click the "I decline" button." The on-screen buttons are clearly identified. The underlined text is a hypertext link which, if selected, promptly displays the license. The system prevents the licensee from use of or access to the information without indicating "I agree." *A party that indicates "I agree" manifests assent to the license and adopts the terms of the license*

Illustration 2: The first screen of an on-line stock-quote service requires that the potential licensee enter a name, address and credit card number. After entering the information and striking the "enter" key, the licensee has access to the data and receives a monthly bill. In the center of the screen amid other language in small print, is the statement: "**Terms and conditions of service; disclaimers".** The customer's attention is not called to this sentence nor is the customer asked to react to it. *Even though entering name and identification coupled with using the service, assents to a contract, there is no assent to the "terms of service" and disclaimer since these were not called to the party's attention and there is no act indicating assent to the record containing the terms. A court would determine the contract terms on other grounds, including the default rules of this Article*

4. *Objective standard.* Manifesting assent requires that, from all the facts known to it, a reasonable person should know that particular conduct will indicate that the actor assents to the record. Actions indicating assent are effective even though the actor subjectively intends otherwise. This section follows traditional contract law theory of "objective" manifestation of assent. This is especially important in electronic commerce where many transactions do not involve direct contacts between individuals. Information providers and licensees must rely on **actions** as confirming the existence of a contract, and the acceptance of contract terms. Doctrines of mistake, supplemented by Section 2B-118, as well as doctrines invalidating the effects of fraud and duress apply in appropriate cases.

5. *Electronic Agents.* Article 2B recognizes the enforceability of assent through automated systems ("electronic agents"). In electronic commerce, there is a widespread and rapidly increasing use of such computer programs (often described as "bots" or "intelligent agents") programmed to search (on behalf of a potential purchaser) or make available (on behalf of a potential licensor) particular types of information under set contractual terms and alternatives.

The licensee, the licensor, or both may use electronic agents. The potential for reduced transaction costs and the benefits in enabling international comparative shopping are immense for consumers and for providers of information. With electronic agents, assent cannot require knowledge or reason to know. The inquiry is whether the circumstances clearly indicate that the operations of the automated system indicate assent. Safeguards are placed through unconscionability doctrine and Section 2B-204 indicating that an electronic agent can only assent to terms to which it can react.

6. *Other Means of Assent.* Manifestation of assent to a record is not the only way in which parties define their bargain. This Article does not alter traditional recognition of other methods of agreement in general law. For example, a product description can become part of an agreement without manifestation of assent to a record repeating the description; the product description defines the bargain itself. Thus, a party that markets a database of intellectual property attorneys can rely on the fact that the product need only contain intellectual property attorneys because this is the basic bargain; the provider is not required to obtain manifest assent to a record restating that element of the deal.

The nature of the product defines the bargain if the party knew of it in making a purchase, the terms became part of the basis of the bargain, or if other methods are used to call attention to the term and the party accepts it. If a copyrighted software product is clearly identified on the package or in representations to the licensee as being for consumer use only, the terms are effective if part of the agreement without requiring pro forma language in a record restating the description or conduct assenting to that record.

Similarly, in many cases, copyright or other intellectual property notices or restrictions may effectively restrict use of a product, regardless of whether there is a manifestation of assent under this Section. For example, common practice in video rental arrangements places a notice on screen of the limitations imposed on the customer's use of the video under applicable copyright and criminal law, such as by precluding commercial public performances. The enforceability of such notices does not depend on compliance with this section.

7. *Authority to Act.* The person manifesting assent must be one that can bind the party being charged with the benefits or restrictions of the agreement or the record. If a party proposing a record desires to bind the other party, it must establish that the person who acted had authority to do so or, at least, that the entity allegedly represented accepted the benefits of the contract or otherwise ratified the actions of the individual. Concept of apparent authority may apply. Of course, if the person who manifested assent

did not have authority and the conduct was not ratified or otherwise adopted , there may be no license. If this is the case, use of the information will often infringe a copyright.

There must be a connection between the person who had the opportunity to review and one whose acts constitute assent. Thus, an email sent to the company at large, or to the company's computer, does not trigger assent to the email unless it comes to the attention of one who can and does act to commit the company to a binding assent to terms under rules of attribution or estoppel. Of course, a party with authority can delegate that authority to another. Thus, a CEO may implicitly authorize her secretary to agree to a license when she instructs the secretary to sign up for Westlaw online or to install a newly acquired program that is subject to a screen license.

Questions of this sort arise under agency law as augmented in this Article. In appropriate cases, Article 2B rules regarding attribution play a role in resolving whether the ultimate party is bound to the contract terms. Section 2B-116 indicates deals with when, in an electronic environment, a party is bound to records purporting to have come from that party. This Article, however, does not generally address questions of agency law. See § 1-103.

8. *Assent to particular terms.* The section distinguishes assent to a record and, if required by other provisions of this article, assent to particular terms. Assent to a record involves conduct, expressions or an authentication with respect to a record as a whole, while assent to a particular term, if needed, requires acts that relate to that particular term. One act, however, may assent to both the record and the term if the circumstances, including the language of the record, clearly so indicate to the party doing the act.

9. *Proof of Terms.* Of course, it will be necessary for the party, if it relies on the terms of linked text or other electronic records, to prove the content of the text at the time of the licensee's assent. One way of doing so is to retain records of the content at all periods of time or maintaining a changes occurred in particular records.. The issues of proof, while potentially difficult, are matters of evidence law and reflect ordinary problems encountered in dealing with proof of electronic records.

2B-112. OPPORTUNITY TO REVIEW; REFUND.

(a) A person or electronic agent has an opportunity to review a record or term only if the record or term is made available in a manner that:

(1) in the case of a person, ought to call it to the attention of a reasonable person and permit review; or

(2) in the case of an electronic agent, would enable a reasonably configured electronic agent to react to the record or term.

(b) Except as otherwise provided in subsection (c), if a record or term is available for review only after a person becomes obligated to pay, the person has an opportunity to review only if the person has a right to a refund under Section 2B-208 or otherwise if it rejects the terms of the record.

(c) If a record or term contains a proposal to modify a contract or is governed by Section 2B-207(a)(2) and is not a mass-market license, a right to a refund is not required for there to be an opportunity to review.

Definitional Cross References:

"Contract". Section 2B-102. "Electronic agent". Section 2B-102. "License": Section 2B-102. "Record". Section 2B-102. "Refund": Section 2B-102. "Term". Section 1-201.

Notes:

1. *General Concept.* "Opportunity to review" is a precondition to manifesting assent. Unless a party had a prior opportunity to review, actions purportedly manifesting assent to a record are ineffective.

On the other hand, the mere fact that a person foregoes or ignores the opportunity and proceeds with a transaction does not mean that there was no opportunity to review. Thus, for example, contract terms presented to the party during an over the counter transaction or conspicuously made available in a binder as required for some transactions under federal law give an opportunity for review even if the party does not avail itself of that opportunity. This is not changed by the fact that the party desires to hurry through and complete the transaction unless, of course, the other party uses undue pressure to cause the party to not review the record.

2. *Refund.* The opportunity to review can come at or after payment. If it follows payment, there is no opportunity to review for purposes of this Article unless the party can return the product an receive a refund if it declines the terms of the record. This refund right does not exist in current law. **See Carnival Cruise Lines, Inc. v. Shute**, 499 U.S. 585 (1991); **Hill v. Gateway 2000, Inc.,** 1997 WL 2809 (7th Cir. 1997). It creates important protection for the licensee.

This Article conditions the adoption of terms between the licensor and the licensee on the existence of that opportunity in some cases. Failure to provide a refund is not a breach of contract, but results in failure of the terms to become part of the bargain.

3**.** *Modifications.* Ideas of a refund opportunity associated with the opportunity to review do not alter law relating to the modification of an agreement or the provisions in Section 2B-207 dealing with commercial contracts where parties begin performance in the expectation that a record containing the contract terms will be presented later and adopted. In these cases, general contract law principles apply.

4. *First User.* The refund exists only for the first user. In general, subsequent parties are bound by the first contract in the sense that they are not authorized to exceed the limitations of the first agreement.

> **Illustration:** Producer transfers a copy of a musical work to User, subject to a license that restricts use to home use only. The license terms are presented after delivery of the copy. User can either assent to the license or obtain a refund. It assents. User later transfers the copy to Jones. Jones need not receive a refund right. If Jones uses the music in a commercial context, the license is breached. Producer has contract recourse against User. Producer may also have a copyright claim against Jones.

[B. **Electronic Contracts: Generally**]

The provisions for electronic contracting will be coordinated between the Article 2B Committee and the Electronic Transactions Committee to ensure that the policies implemented will be parallel. These provisions should also be considered by the Article 2 and 2A committees.

2B-113. LEGAL RECOGNITION OF ELECTRONIC RECORDS AND AUTHENTICATIONS. A record or authentication may not be denied legal effect solely on the ground that it is in electronic form.

Definitional Cross References:

"Authentication". Section 2B-102. "Electronic". Section 2B-102. "Record." Section 2B-102.

Official Comments:

This section states a fundamental principle of electronic commerce. It derives from digital signature and electronic signature law in several states. The mere fact that a message or record is electronic does not alter or reduce its legal impact. Of course, this principle is restricted to the scope of Article 2B. It does not apply to instruments, documents of title, or similar applications of electronic commerce. Under Section 2B-103(b), the subject matter of those other areas is excluded from Article 2B.

2B-114. COMMERCIAL REASONABLENESS OF ATTRIBUTION PROCEDURE. The commercial reasonableness of an attribution procedure is to be determined by the court. In making this determination, the following rules apply:

(1) An attribution procedure established by statute or regulation is commercially reasonable for transactions within its coverage.

(2) Except as otherwise provided in paragraph (1), commercial reasonableness is determined in light of the purposes of the procedure and the commercial circumstances at the time the parties agree to or adopt the procedure.

(3) A commercially reasonable attribution procedure may use any security device that is reasonable under the circumstances.

Uniform Law Source: Article 4A-201; 202.

Definitional Cross References:

"Attribution procedure": Section 2B-102. "Court": Section 2B-102.

Official Comments:

1. *Purpose and Effect of a Commercially Reasonable Attribution Procedure.* A commercially reasonable attribution procedure that is followed gives enhanced legal recognition to a message or performance. Conforming to a commercially reasonable attribution procedure set out for that purpose results in an authentication as a matter of law. If the issue is who sent the message or performance, compliance with a commercially reasonable attribution procedure to identify a party makes the alleged originator of the message attributable (presumptively) for the message or performance. On the other hand, failure to use a commercially reasonable authentication procedure does not indicate that no authentication occurred or that the purported sender is not responsible for the message or performance.

2. *Agreement or Adoption.* This Article does not dictate what constitutes a commercially reasonable procedure. Evolving technology and commercial practice make it impractical to predict future

developments and unwise to preclude these developments by a narrow statutory mandate. Instead, the Article relies on the parties to select a procedure. An attribution procedure must be established by agreement or adopted by both parties. A procedure of which one party is not aware, does not qualify. On the other hand, parties dealing for the first time may adopt a procedure for authentication of messages.

3. *Commercially Reasonable.* The requirement of reasonableness buffers against over-reaching and protects parties who lack knowledge of technology. What is a commercially reasonable procedure must take into account the cost relative to value of transactions. How one gauges commercial reasonableness depends on a variety of factors, including the agreement, the then current technology, the types of transactions affected by the procedure and other variables.

2B-115. EFFECT OF REQUIRING COMMERCIALLY UNREASONABLE ATTRIBUTION PROCEDURE.

(a) Subject to subsection (b) and Section 2B-116, between parties to an attribution procedure, a party that requires use of an attribution procedure that is not commercially reasonable as a condition for entering a transaction is liable for losses caused by reasonable reliance on the procedure in a transaction for which the procedure was required.

(b) The liability of a party under subsection (a) is limited to losses in the nature of reliance or restitution. The party's liability does not extend to:

(1) loss of expected benefit;

(2) consequential damages;

(3) losses that could have been prevented by the exercise of reasonable care by the aggrieved party; or

(4) a loss the risk of which was assumed by the aggrieved party.

(c) For purposes of subsection (a), a person does not "require" a procedure if the person makes available to the other person a commercially reasonable alternative electronic or non-electronic procedure and the other person selects a commercially unreasonable procedure.

Definitional Cross References:

"Attribution procedure": Section 2B-102. "Consequential damages": Section 2B-102. "Electronic": Section 2B-102.

Notes:

1. *General Policy and Scope.* This section deals with allocation of loss in cases where one party (either the licensor or the licensee) requires use of an attribution procedure that is commercially unreasonable and use of that procedure causes a loss either because of undetected errors in transmissions or records or because of third party activity in the nature of fraud or otherwise. The Section does not cover all cases in which such loss might occur, but deals only with circumstances in which a party is in a position to and does in fact **require** use of the commercially unreasonable procedure. A procedure negotiated or jointly selected by the parties, selected from among alternatives that include a commercially reasonable option, or mutually designed, does not fall within this Section. Responsibility for loss in such cases lies outside this article.

a. Reliance Loss. The basic premise is that, all things being otherwise equal, loss in the nature of reliance or restitution should fall on the party that required use of the procedure that caused the loss. This is a contract statute, not a general regulatory or tort liability statute and, thus, the losses to which it applies are limited to situations in which loss results from use of the procedure in a transaction to which the requirement applies.

b. Transactions Not Affected. This article deals with licensing and related transactions. The losses allocated here are limited to such transactions. The Section does not apply to credit card, funds transfer or other transactions in which attribution procedures are used, but which are outside Article 2B.

c. Relationship to Reasonable Procedures. The loss allocation rule in this Section is subject to the rules in Section 2B-116 and 2B-117. Those sections establish presumptions about the electronic records to which the procedures apply. The presumptions arise only if a procedure is commercially reasonable. A commercially unreasonable procedure vitiates the presumption, leaving the parties to general proof of content and source of the record. In addition, if the procedure is within this section, it may alter loss allocation.

2. *Party Responsible.* The section makes the person that required the procedure responsible for the loss. In modern commerce, the person making such requirement is in some cases the licensor and in some cases the licensee. The rule here applies in either direction. The Section does not necessarily

create an affirmative right of recovery. In some cases, it merely denies the relying party an right to recover **from** the other person.

Example, a licensor acting pursuant to a commercially unreasonable attribution procedure, might ship information product to a third party that used the inadequacies of the procedure to dupe the licensor into believing that the party requesting shipment was the named licensee. If the licensor had required the procedure and the licensee had agreed to it for transactions of this type, this Section allows the licensee to resist any effort by the licensor to charge the licensee for the loss or the contract price. The licensor remains responsible. On the other hand, if the licensee had required the procedure and the licensor agreed to it, the licensor may recover against the licensee for the losses in the nature of reliance. It cannot, of course, in this case seek recovery under contract theory since the licensee did not make the purchase request..

3. *Type of Loss*, The loss to which this Section applies is limited in several ways.

The loss must, initially, come **from** use of the procedure. This excludes losses from other causes. Thus, if an identifier is unreasonable, but the party actually did engage in the transaction, but suffered loss due to a breach of contract, this section does not apply. The losses addressed here are from misattribution of who sent a message or from tampering with the content.

Second, the Section only applies to losses incurred in transactions to which the requirement and use of the procedure between the parties applies. It does not address the difficult problem of liability where a third party obtains social security or other important identifiers and uses them to fraudulently obtain goods and services from other vendors. That issue lies in tort law, criminal law, and other regulation that is just now developing.

Third, the losses are limited to reliance and restitution recovery. In some cases, however, the existence and non-performance of a contractual relationship may allow expectations recovery. The basic premise here, however, is limited to avoiding a shift of losses through a required procedure that fails to protect the interests of the parties.

The emphasis on reliance recovery, of course, places further limitations on the recovery. These are stated in subsection (b)(2) based on a lack of reasonable care and an assumption of risk.

4. *Illustrations.* The following suggest some applications of this Section.

a. False Identity Cases: No Contract. In many cases where a loss is suffered by a party because a third party fraudulently used an attribution identifier and order information claiming to the appropriate party, this Section produces results that are parallel to the results that could be inferred under other attribution rules of this Article.

Illustration 1. S (the vendor) required and M agreed to a procedure for identifying M in placing orders with S. Thief misuses this procedure and, purporting to be M, obtains a $10,000 electronic encyclopedia from S. S, believing that M placed the order, seeks the license fee from M. Under the general attribution sections, if the procedure is not commercially reasonable, there is no presumption that the sender was M and, since M can prove it was not the sender, it has no liability. Under this section, the required attribution procedure caused a loss, but S is responsible for that loss. It cannot shift loss to M.

In some false identity cases, however, the party demanding the use of the attribution procedure may be responsible for affirmative losses.

Illustration 2. M (the purchaser) requires L to use a procedure under which M identifies itself when placing orders with L. Thief uses the procedure to fraudulently obtain a $10,000 software system from L. Under this Section, since M required use of the procedure and it was commercially unreasonable, the loss suffered may be recovered from M. The amount of loss is measured by reliance, not lost profit. In essence, the recovery is the cost (not license price) of the software shipped to the thief plus related expenses.

b. True Contract: Errors in Performance. In cases where an actual contract exists between the parties and the error or fraud allowed by the unreasonable attribution procedure relates to performance, it will often be the case that contract remedies provide the primary recovery and, under the principle that precludes double recovery, the reliance loss allocation of this does not create affirmative recovery. It nevertheless confirms the placement of ultimate losses in such cases.

Illustration 3. L (licensor) and M (licensee) agree to a $10,000 commercial software license. L requires M to agree to a procedure for sending instructions as to where to transmit the software. M pays the license fee. A third party causes misdirection of the copy. M demands its software. Under this Section, L bears responsibility for reliance or restitution loss. M can recover the fee it paid. M can enforce the unperformed contract and, in the event of breach, can recover damages as appropriate.

Illustration 4. In the Illustration 3, assume that M did in fact direct the transmission of the software, but now denies that it did so. If the procedure had been reasonable, L would have the advantage of a presumption of attribution of the message. Since it was not, L must prove that M did send the message without the benefit of a presumption. If it can do so, it can enforce the contract. Under this section, M suffered no loss due to the attribution procedure.

c. Errors in the Offer and Acceptance. Problems of garbled, misrecorded or otherwise mistaken offers and acceptances are of long-standing in commercial practice. This Section provides a method of allocating loss in such cases based on the reasonableness of the required procedure and independent of asking arcane questions about what terms were accepted and when,.

Illustration 5. M requires that L use an unreasonable attribution procedure for transmitting orders and acceptances. L agrees. It places an order for ten software widgets. Because the procedure is flawed, the message arrives at M requesting 100 software widgets. M ships on that basis. L desires to return the ninety excess widgets to M and not pay. One could argue that no contract exists because of mistake.

Alternatively, a contract might be formed on the offer as sent or as received. Case law support exists for either result. This section cuts past the issue and focuses on reliance loss. Either L or M could be said to suffer loss because of reliance. Since M required it, M bears responsibility for the loss. It cannot demand the price for the ninety widgets unless, of course, L decides to retain them. If L had required the use of the procedure, it would be responsible for reliance losses and restitution.

2B-116. DETERMINING TO WHICH PERSON AN ELECTRONIC AUTHENTICATION, MESSAGE, RECORD, OR PERFORMANCE ATTRIBUTED; RELIANCE LOSSES.

(a) Subject to subsection (b), an electronic authentication, message, record, or performance is attributed to a person if:

(1) it was in fact the act of that person or the person's electronic agent; or

(2) the receiving person, in accordance with a commercially reasonable attribution procedure for identifying a person, reasonably concluded that it was the action of the other person or the person's electronic agent.

(b) Attribution under subsection (a) (2) has the effect provided by the statute, regulation, or agreement and, in the absence of provisions in the statute or regulation, or terms in the agreement creates a presumption that the authentication, message, record, or performance was that of the person to which it is attributed.

(c) If the presumption in subsection (b) applies and a person rebuts the presumption, that person is nevertheless liable for losses of the other party in the nature of reliance if the losses occur because:

(1) the person rebutting the presumption failed to exercise reasonable care;

(2) the other party reasonably relied on the belief that the person was the source of an electronic authentication, message, record, or performance;

(3) the reliance resulted from acts of a third person that obtained access numbers, codes, computer programs, or the like from a source under the control of the person rebutting the presumption; and

(4) the use of the access numbers, codes, computer programs, or the like created the appearance that it came from the person rebutting the presumption.

Uniform Law Source: 4A-202; 4A-205; UNCITRAL Model Law.

Definitional Cross References.

"Attribution procedure: Section 2B-102. "Computer program": Section 2B-102. "Electronic": Section 2B-102. "Electronic agent". Section 2B-102. "Electronic message": Section 2B-102. "Good faith": Section 2B-102. "Party": Section 1-201. "Person": Section 1-201. "Presumption": Section 1-201. "Record": Section 2B-102.

Official Comments:

1. *Attribution to a Person.* Attribution to a person means that the electronic record is treated in law as having come from that person. This section balances goals of enabling electronic commerce in an open environment, while stating reasonable standards to allocate risk in that setting. The rules do not apply to funds transfers, bank accounts, credit card liability, or other subject matter outside Article 2B.

2. *Act of the Person or Electronic Agent.* There are two circumstances under which a message or action is attributed to a party. The first (subsection (a)(1)) simply makes a person responsible for the record or

performance if the person or its agent actually performed or actually created the record. General agency law applies for human agents. In addition, a person is responsible for the actions of its electronic agent. An "electronic agent" is an automated system that responds to or initiates actions without human review. Having opted to use an automated system, the person is responsible for its operations. The person who set out the automated system has responsibility for its conduct. The rules parallel the UNCITRAL Model Law. Article 13.

3. *Use of Attribution Procedure.* Subsection (a)(2) makes a message attributable to a person if the other party used the procedure and reached the conclusion that it came from the other person because of that use. Attribution in this form creates a presumption that it was the party identified who sent the message, created the record, or engaged in the performance or authentication. The presumption is rebuttable.

4. *Duty of Care.* Subsection (c) deals with a situation where the rebuittable nature of the presumption created under subsection (a) arises. The issue focuses on loss allocation. If a procedure was used, but a third party actually sent the message, the relying party can nevertheless obtain protection against reliance loss if it proves that the loss was caused by the other party's negligence.

The subsection does not create an omnibus risk of liability. The loss allocation principle recognizes protected reliance where the cause of the reliance lies in a lack of reasonable care by the person to whom the message is attributed. Since this is reliance-based liability, if the message, performance or context indicates that the indicated source is incorrect or gives reason to doubt the source, reliance may not be protected.

Current law uses several different approaches to analogous problems: 1) in the telephone system, a person is responsible for any charges incurred for long distance calls from its equipment and using its number; fault and authorization are irrelevant; 2) credit card and electronic funds regulations limit liability for a consumer for unauthorized use of its card or number; 3) in commercial funds transfers, the presence or absence of a "security procedure" conditions risk; 4) in check collections, an absolute liability rule is imposed on many recipients of fraudulent instruments unless the party whose signature was forged negligently contributed to the fraud.

Article 2B adopts an intermediate position. Unlike in credit card and funds transfer systems, one cannot predict the relative nature of the sending and receiving parties, their economic strength, or technological sophistication. Individuals with limited resources are as likely to be on either side of a transaction in electronic commerce as are large corporations. Because of this, the rule creating a dollar cap for consumer risk for credit cards and funds transfers is not viable in this open system, heterogeneous environment. Our context requires a general structure that goes beyond consumer issues; the problems will not routinely entail consumer protection questions or, even, a licensor with better ability to spread loss.

2B-117. ATTRIBUTION PROCEDURE FOR DETECTION OF CHANGES AND ERRORS: EFFECT OF USE. If the parties use a commercially reasonable attribution procedure to detect errors or changes in an electronic record, as between the parties, the following rules apply:

(1) The effect of the procedure is determined by the agreement or, in the absence of terms about the effect, by this section or the law establishing the procedure.

(2) An electronic authentication, message, record, or performance that the attribution procedure indicates was unaltered since a point in time is presumed to have been unaltered since that time.

(3) An electronic authentication, message, record, or performance created or sent pursuant to the attribution procedure is presumed to have the content intended by the person creating or sending it as to portions to which the procedure applies.

(4) If the sender complies with the attribution procedure, but the receiving party does not, and the change or error would have been detected had the receiving party also complied, the sender is not bound by the error or change.

Definitional Cross References.

"Attribution procedure": Section 2B-102. "Electronic": Section 2B-102. "Electronic message". Section 2B-102. "Party". Section 1-201. "Presumed." Section 1-201. "Record". Section 2B-102. "Send". Section 2B-102.

Official Comments:

1. This Section deals with the effect of commercially reasonable attribution procedures dealing with the detection of error or of changes in the content of electronic records. As is true throughout the Article, the effect can be determined by agreement. In the absence of terms on this point, use of commercially reasonable procedures creates a presumption regarding the accuracy or unchanged nature of the record.. Other presumptions may be appropriate depending on the nature of the procedure and this

section does not foreclose their development by courts. The underlying principle is that, if the parties agree to or adopt a commercially reasonable procedure, records created or transferred in compliance with that procedure are entitled to enhanced legal recognition. The presumption is rebuttable and is conditioned on the procedure used qualifying as a commercially reasonable attribution procedure. This means not only that the procedure was commercially reasonable, but that the procedure was agreed to or adopted by the parties.. The language here comes largely from pending Illinois Digital Signature statute which contains more detailed provisions regarding secure electronic records. Since the principle enacted here hinges on agreement and general considerations of commercial reasonableness, the concept is technologically neutral.

2. The presumptions are limited to issues to which the procedure applies. Proof or disproof of alleged errors is left to law outside this Article. The common law of mistake applies as does case law on the legal consequences of garbled or forged transmissions.

3. Subsection (a)(4) deals in a limited way with the effect of a failure of one party to conform to an existing attribution procedure that is commercially reasonable (the effect of a failure to comply with a procedure that is not commercially reasonable is treated in Section 2B-114). Where the sender complies, but the recipient does not, the sender is absolved from any liability under contract law for an error that would have been detected through compliance.

2B-118. ELECTRONIC ERROR: CONSUMER DEFENSES.

(a) In this section, "electronic error" means an error created by an information processing system, by electronic transmission, or by a consumer using an electronic system, if a means for correction or avoidance of such errors was not reasonably providedallowed.

(b) In an automated transaction consumer transaction, the consumer is not bound by an electronic message that the consumer did not intend and which was caused by an electronic error if the consumer:

(1) promptly on the earlier of learning either of the error or of the other party's reliance on the message:

(A) in good faith notifies the other party of the electronic error and that the consumer did not intend the original message; and

(B) delivers all copies of any information it receives to the other party or delivers or destroys all copies pursuant to any reasonable instructions received from the other party; and

(2) has not used or received a benefit from the information or informational rights or caused the information or benefit to be made available to a third party.

(c) In all cases not governed by subsection (b), the effect of the error is determined by other law.

Prior Uniform Law: None.

Definitional Cross Reference.

"Automated transaction": Section 2B-102. "Copy": Section 2B-102. "Consumer transaction": Section 2B-102. "Electronic": Section 2B-102. "Electronic message": Section 2B-102. "Good Faith": Section 2B-102. "Information". Section 2B-102. "Information processing system": Section 2B-102. "Informational Rights": Section 2B-102. "Notifies": Section 2B-201. "Party": Section 1-201. "Receive": Section 2B-102.

Official Comments:

Common law principles about mistakes provide the basic framework against which problems of error and mistake will be resolved. This Section sets out a specific application of those principles to establish a new protection for consumers in automated transactions. The protection created here provides a simple method for a consumer to contest errors in the consumer's transmissions to a third party. Under common law, in many instances, in a unilateral mistake, the party making that error is liable for its consequences. This Section rejects those decisions to protect consumer in modern commerce.

The right here is grounded in equity principles that allow a party to avoid the adverse consequences of its error if the error causes no detrimental effect on another party and does not produce a benefit for the person making the mistake. Of course, there will be unavoidable minor detrimental effects on the party who receives an erroneous message (e.g., costs of filling, handling and delivering erroneous orders), so courts should apply this rule with care. The basic assumption is that if there is no detrimental effect on the person who did not cause the error is particularly suspect if manufacturing, production, or other costs are significant. Also, a vendor who fills erroneous orders in a just-in-time inventory system can incur considerable costs for products such as computers or cars; where the product is information, the premise is that the lesser cost of manufacturing justifies the rule.

This section does not create a right to rescind a contract because a consumer changes its mind. The section deals solely with errors in creation of a contract. There must have been no intent to make the order or, at least, to order the quantity transmitted in error.

Illustration 1: Consumer intends to order ten copies of a video game from Jones. In fact, the information processing system records 110. The electronic agent maintaining Jones' site disburses 110 copies. The next morning, Consumer notices the mistake. He sends an E-Mail to Jones describing the problem, offering to immediately return or destroy copies; he does not use the games. Under this section, performing on these offers means that there is no presumption that the contract was for 110 copies. If it desires to enforce the apparent contract, Jones must prove that there was no error.

Illustration 2: Same facts, except that Jones' system before shipping sends a confirmation, asking Consumer to confirm that it ordered 110 games. Consumer confirms 110 copies. This section no longer applies. If Consumer sees the confirmation request and does not respond, the section also does not apply. In either case, the system reasonably allowed for correction of the error.

2B-119. PROOF OF AUTHENTICATION; ELECTRONIC AGENT OPERATIONS.

(a) Operations of an electronic agent constitute the authentication, manifestation of assent, or performance of a person if the person used the electronic agent for such purpose.

(b) Compliance with a commercially reasonable attribution procedure for authenticating a record authenticates the record as a matter of law. Otherwise, authentication may be proven in any manner, including by showing that a procedure existed pursuant to which a party or an electronic agent must have engaged in conduct or operations that authenticated the record or term in order to proceed further in the use it made of the information or informational rights.

(c) Unless the circumstances indicate otherwise, authentication is deemed to have been done with the intent to establish the person's identity, its adoption or acceptance of the record or term, its acceptance of the contract, and the integrity of the records or terms as of the time of the authentication.

Definitional Cross References.

"Attribution procedure": Section 2B-102. "Authenticate:" Section 2B-102. "Contract". Section 1-201. "Electronic agent". Section 2B-102. "Information". Section 2B-102. "Informational Rights": Section 2B-102. "Record": Section 2B-102.

Official Comments:

1. Subsection (a) contains a specific application of the general principle that actions of an electronic agent bind the party that selected and deployed the agent for that purpose. An electronic agent is an automated system of response or originating messages or performances. A party that uses such systems is bound by its operations.

2. Under subsection (b), compliance with an attribution procedure for that purpose removes fact questions about whether an authentication occurred. In the absence of use of an authentication procedure, proof of an authentication can occur in any manner. Included in the methods of proving authentication is proof that shows that a process exists that required an authentication in order to enable an automated system to proceed further in use or other operations. This rule reflect on-line and on-screen methodologies that are increasingly common and removes doubt about whether that type of proof is sufficient.

2B-120. ELECTRONIC MESSAGES: TIMING OF CONTRACT; EFFECTIVENESS OF MESSAGE; ACKNOWLEDGING MESSAGES.

(a) Except as otherwise provided in subsection (b), an electronic message is effective when received even if no individual is aware of its receipt. If an offer in an electronic message initiated by a person or an electronic agent evokes an electronic message in response, a contract is formed:

(1) when an acceptance is received; or

(2) if the response consists of furnishing the information or access to the information, when the information or notice of access is received or use is enabled, unless the originating message required acceptance in a different manner.

(b) If the originator of an electronic message requests or has agreed with the addressee that receipt be acknowledged electronically, the following rules apply:

(1) A message expressly conditioned on receipt of an electronic acknowledgment does not bind the originator until the acknowledgment is received. The message is no longer effective if the

acknowledgment is not received within the time specified for receipt or, in the absence of a specified time, within a reasonable time after the message was sent.

(2) If the message was not expressly conditioned on electronic acknowledgment and the acknowledgment is not received within the time specified for receipt or, in the absence of a specified time, within a reasonable time after the message was sent, the originator, on notice to the other person, may:

(A) treat the message as no longer effective; or

(B) specify a further time for acknowledgment and, if acknowledgment is not received within that time, treat the message as no longer effective.

(c) Receipt of an electronic acknowledgment creates a presumption that the message was received, but the acknowledgment does not in itself establish that the content sent corresponds to the content received.

Definitional Cross References.

"Electronic agent": Section 2B-102. "Electronic message": Section 2B-102. "Information": Section 2B-102. "Person": Section 1-201. "Presumption": Section 2B-102. "Receive": Section 2B-102.

Official Comments:

1. Subsection (a) adopts a time of receipt rule; rejecting the mail box rule for electronic messages.

2. This section does not deal with attribution or liability questions. Questions of attribution are treated in Sections 2B-111-118. For example: if a "response" purports to be from ABC Corp., the message, while effective at a given point in time under this section, does not bind ABC unless the message can be attributed to it under agency law or attribution rules in this Article or common law.

3. A contract can exist even if no human being reviews or reacts to the electronic message or the information delivered. This adapts traditional theories of consent and agreement to electronic commerce. In electronic transactions, automated systems can send and react to messages without human intervention; when parties choose to use these systems, there is no reason not to allow contract formation. A contract rule that demands direct human assent would inject an inefficient and error prone element in the modern electronic format.

4. Subsection (b) deals with electronic acknowledgments. The effect of a request for acknowledgment depends on whether the request made the message conditional on acknowledgment or merely requested acknowledge. As a basic principle, the message sender can control the legal effect of its messages if it does so expressly. Acknowledgment, of course, is not acceptance; although an acceptance can and often will serve as sufficient recognition of the message to also as acknowledgment. Acknowledgment confirms receipt. In modern electronic systems, this often occurs automatically on receipt of the electronic message in the recipient's system.

5. This section deals with functional acknowledgments. It does not create presumptions other than that an acknowledgment indicates that the message was received. Questions about accuracy of the received message and about time of receipt, content and other issues are not treated. Of course, by agreement the parties can extend this concept to cover such issues.

PART 2

FORMATION AND TERMS

[A. General]

2B-201. FORMAL REQUIREMENTS.

(a) Except as otherwise provided in this section, a contract requiring payment of $5,000 or more is not enforceable by way of action or defense unless:

(1) there is a record authenticated by the party against which enforcement is sought sufficient to indicate that a contract has been formed and reasonably to identify the copy or subject matter to which the contract refers; or

(2) the contract is a license for an agreed duration of less than one year.

(b) A record is sufficient under subsection (a) even if it omits or incorrectly states a term, but the contract is not enforceable beyond the copy or subject matter shown in the record.

(c) A contract that does not satisfy the requirements of subsection (a), but which is valid and enforceable in all other respects, is enforceable if:

(1) a performance was tendered or the information was made available by one party and the tender was accepted or accessed by the other; or

(2) the party against which enforcement is sought admits in its pleading or testimony or otherwise in court that a contract had been formed, but the agreement is not enforceable under this paragraph beyond the copy or subject matter admitted.

(d) Between merchants, if within a reasonable time a record in confirmation of the contract and sufficient against the sender is received and the party receiving it has reason to know its contents, the record satisfies the requirements of subsection (a) against the party receiving it unless notice of objection to its contents is given in a record within 10 days after the confirming record is received.

(e) The rules in Section concerning the interpretation of rights granted may be varied only by a record that is:

(1) sufficient to indicate that a contract has been made; and

(2) authenticated, or prepared and delivered to the other party, by the party against which enforcement is sought.

(f) An agreement that the requirements of this section need not be satisfied as to future transactions is effective if it is in a record that satisfies subsection (a).

(g) This section is the only statute of frauds applicable to transactions within this article.

Uniform Law Source: Section 2A-201. Revised.

Definitional Cross References:

"Agreement": Section 1-201. "Authenticate": Section 2B-102. "Contract": Section 1-201. "Copy": Section 2B-102.

"Court": Section 2B-102. "Information": Section 2B-102. "License": Section 2B-102. "Merchant": Section 2B-102. "Notice": Section 1-201. "Party": Section 1-201. "Reason to know": Section 2B-102. "Receive": Section 2B-102. "Record": Section 2B-102. "Term": Section 1-201.

Official Comments:

1. *General Policy and Background.* This section establishes a statute of frauds tailored to information transactions. A statute of frauds provides important protections in commerce focused on intangible subject matter. This is true because of the character of the subject matter, the threat of infringement, and the split interests involved in a license with ownership of intellectual property rights in one party while rights or privileges to use or to possess a copy vest in another party. These considerations augment arguments that propose that providing some protection against fraudulent practices and unfounded claims justify the cost of the statute.

2. *Basic Rule: Subject Matter and Value.* The record, when required, must reasonably describe the subject matter or copies involved. This leaves significant elements of scope of a license not required in the documentation. Disputes about scope, however, may indicate that no contract exists. See Section 2B-202. A record is required only if the transaction requires payments in excess of $5,000 and it is a license whose fixed duration exceeds one year. Both the $5,000 and the one year rule, refer to what the contract affirmatively requires, rather than to what might occur under some variations of the agreed terms. Thus, an indefinite term contract which can be terminated at will does not require a writing since the term is not in excess of one year. A contract calling for royalty payments whose total amount hinges on the success of a product does not exceed the $5,,000 amount even if, in fact, the royalties later prove to far exceed that number unless a minimum amount is required and exceeds this figure.

3. *Basic Rule: Record.* There is no requirement that the record be retained. Obviously, on questions of proof, retaining a record of a contract is good practice, but this Act merely requires that the record exist at one point in time. In electronic systems, a "record" requires that information be in a form from which it can be perceived. This section does not take a position on how long the information must be in this form. In copyright law, the cases do not impose a minimum time period, but do distinguish between a copy and an ephemeral manifestation of information. That distinction carries forward into Article 2B.

The record must be authenticated by the party to be bound. A party can prove prior existence of an authenticated record by showing that a procedure exists by which an authenticated record must necessarily have been made in order for the party to have proceeded in use of the information or another activity.

4. *Transactional Exceptions: Performance and Admissions.* There are many circumstances in which the requirements of subsection (a) are moot because of other events. Two are described in subsection (c).

The first obviates the requirements of the statute of frauds if performance has been offered and accepted. This adequately documents the existence of the contract to the extent of the performance and the minimal record required under the statute is not necessary. The second supplants the statutory requirements to the extent a person admits the existence of the contract in a sworn statement in connection with litigation. The statement confirms the existence of the contract and supplants the writing requirement.

5. *Transactional Exceptions: Confirming Memoranda.* As in Article 2, this Section provides that, as between merchants, confirming memoranda satisfy the statute if the receiving party does not object within ten days after their receipt. This validates practice in a number of industries where the volume of transactions make it impossible to prepare and receive assent to records as part of making the initial agreement. The confirming memorandum can be in various forms, but it serves to place the other party on notice that a contract has apparently been formed. This memorandum has a validating effect only as between merchants. It removes the statutory bar to enforcement. The party claiming that a contract exists must show that an agreement actually occurred and that other aspects of this Article regarding a contract are met.

6. *Other Agreements.* Subsection (f) makes clear that trading partner or similar agreements are enforceable to alter the statute of frauds issue. The parties can agree to conduct their business without a need for additional, authenticated writings. That agreement satisfies the statute and the policies of requiring that there be some indication that a contract was formed.

2B-202. FORMATION IN GENERAL.

(a) A contract may be formed in any manner sufficient to show agreement, including by offer and acceptance, or by conduct of both parties or operations of electronic agents which recognize the existence of a contract.

(b) An agreement sufficient to constitute a contract may be found even if the time that the agreement was made cannot be determined.

(c) Even if one or more terms are left open or to be agreed upon, a contract does not fail for indefiniteness if the parties have intended to make a contract and there is a reasonably certain basis for giving an appropriate remedy.

(d) In the absence of conduct or performance by both parties to the contrary, a contract is not formed if there is a material disagreement about a material term, including scope.

(e) If a term is to be fixed by later agreement and the parties intend not to be bound unless the term is so fixed, a contract is not formed if the term is not agreed. In that case, each party must return or, with the consent of the other party, destroy all copies of information and other materials already received and return any contract fee paid for which performance has not been received. The parties remain bound with respect by any contractual use restriction with respect to information or copies received from and not returned or returnable to the other party.

Uniform Law Source: Section 2-204; 2-305(4); 2A-204.

Definitional Cross References:

"Agreement". Section 1-201. "Contract". Section 2B-102. "Contract fee". Section 2B-102. "Contractual use restriction": Section 2B-102. "Electronic agent". Section 2B-102. "Information". Section 2B-102. "Licensee". Section 2B-102. "Licensor". Section 2B-102. "Party". Section 1-201. "Receive". Section 2B-102. "Remedy": Section 1-201. "Scope". Section 2B-102. "Term". Section 1-201.

Official Comments:

1. *Basic Rule.* Subsection (a) conforms to current Article 2. It adds an express reference to electronic agents. Article 2B separates two issues. One is whether a contract was formed. The second concerns what terms govern that contract. That latter issue is dealt with in Section 2B-207, 2B-208, and 2B-209. In many cases, of course, the same events create a contract and its terms.

2. *Electronic Agents.* A contract can be formed by the operations of electronic agents. An electronic agent is an automated system used by a person for purposes of achieving contract-related effects.

Giving this effect to an electronic agent can be explained in several ways. One is that it gives force to a choice made by the party. The party selected and deployed the automated system for a purpose and this Article enforces that result. Alternatively, electronic agents could be described as a form of indirect acceptance of a contractual relationship. The agent is a mere extension of the person utilizing it. Under either approach, the automated agent's operations bind the agent's user. In article 2B, reference is simply made to the operations of agents as having specified effects in law and as being attributable in law to a particular party.

3. *Open Terms and Layered Transactions.* As in common law, Article 2B distinguishes preliminary negotiations or incomplete efforts to make a deal that do not create a contract and actions or statements that manifest an intent to be bound even though terms are left open or the time of formation cannot be determined. Ultimately, the distinction often requires consideration of all of the circumstances relating to the alleged agreement.

Under subsection (b), the distinction lies in the existence of an intent to contract as manifested by the language, conduct or operations of the parties or their agents. Given an intent to contract, a contract can be formed despite the existence of terms remaining to be agreed and terms left open by the parties. In the latter case, this Article, general expectations of the trade, and general intellectual property law often provide background rules that flesh out the details of the relationship. The background rules do not apply if the parties disagree about the term. While disagreement may not always bar creation of a contract, it often indicates no agreement.

This Section provides a foundation for recognition of a layered process of contracting which typifies many areas of commerce. There is no requirement that agreement to all terms occur at one point. Contracts are often formed over a period of time, and contract terms are often developed during performance, rather than at the outset. In some cases, these later adopted terms might conceptually be viewed as a modification of an agreement, but it is often the case that the parties expect to arrive a terms and adopt records later in the deal. Rather than a modification, these are more aptly described as a fulfillment of prior expectations or normal practice. This Section recognizes that phenomenon; Section 2B-207 and 2B-208 provide guidance with respect to the adoption of terms. If the parties do not intend to be bound unless later terms are agreed to, subsection (e) gives guidance for unwinding the relationship.

4. *Material Terms and Scope of a License.* Subsection (d) provides simply that a material disagreement about an important (material) term indicates that no intent to enter a contract exists at that time. As described in Section 2B-203, a contract can be formed by an acceptance that varies the terms of the offer. Yet, not all variances indicate an intent to contract. See White & Summers, The Uniform Commercial Code (1995). In information commerce, the most significant terms of a contract deal with the scope of the license. Scope is a defined term. Section 2B-102. It goes to the fundamentals of the transaction and what the licensor intends to transfer and what the licensee expects to receive. Indeed, in many respects, in this field, the contract is the product and scope is the basic product description. Disagreements about this fundamental issue are like ordering a Corvette and confirming purchase of a Volkswagon. They indicate fundamental disagreement about the contract and its subject matter.

2B-203. OFFER AND ACCEPTANCE; ACCEPTANCE WITH VARYING TERMS; ACCEPTANCE OF CONDITIONAL OFFERS.

(a) Unless otherwise unambiguously indicated by the language of the offer or the circumstances, the following rules apply:

(1) An offer to make a contract invites acceptance in any manner and by any medium reasonable under the circumstances.

(2) An order or other offer for prompt or current delivery invites acceptance either by a prompt promise to ship or by the prompt or current shipment of conforming or nonconforming copies. However, a shipment of nonconforming copies is not an acceptance if the party providing the shipment seasonably notifies the transferee that the shipment is offered only as an accommodation to the other party.

(3) If the beginning of a requested performance is a reasonable mode of acceptance, an offeror that is not notified of acceptance and has not received the performance within a reasonable time may treat the offer as having lapsed without acceptance.

(b) Except as otherwise provided in subsections (c) and (d), a definite and seasonable expression of acceptance operates as an acceptance, even though the acceptance contains terms that vary from the terms of the offer, unless the acceptance materially conflicts with a material term of the offer, or otherwise materially varies from the terms of the offer.

(1) If the acceptance contains a material conflict with, or a material variation of, the offer, the following rules apply:

(A) A contract is not formed unless all the other circumstances, including the conduct of the parties, indicate that an agreement existed.

(B) If a contract is formed, the terms of the contract are determined:

(i) under Section 2B-207 or 2B-208, if one party agreed, by manifesting assent or otherwise, to the other party's terms other than by the acceptance that contained the varying terms; or

(ii) under Section 2B-209, if the contract is formed by conduct and subparagraph (B)(i) does not apply.

(2) If a the offer and acceptance contain varying terms but a contract is formed by the acceptance because the variation or conflict was not material, the following rules apply:

(A) The terms of the contract are those of the offer.

(B) Nonmaterial additional terms contained in the acceptance are treated as proposals for additional terms.

(C) Between merchants, the proposed nonmaterial additional terms become part of the contract unless notice of objection to them has already been given or the offeror gives notice of objection to them within a reasonable time after it receives notice of the proposed terms.

(c) Except as otherwise provided in subsection (d), an offer or acceptance that, because of the circumstances or the language is conditional on agreement by the other party to the terms of the offer or acceptance, precludes formation of a contract unless the other party agrees, by manifesting assent or otherwise, to its terms.

(d) If an offer and acceptance are in standard forms and one or both are conditional on acceptance of their terms, the following rules apply:

(1) Conditional language in a standard term of the standard form precludes the formation of a contract only if the party proposing the form acts in a manner consistent with that language, such as refusing to perform, refusing to permit performance, or refusing to accept the benefits of the contract until the proposed terms are accepted.

(2) If a party agrees, by manifesting assent or otherwise, to a conditional offer effective under paragraph (1), it adopts the terms of that offer under Section 2B-207 or 2B-208, as applicable, except to the extent the terms conflict with the express agreement of the parties as to price and quantity.

Uniform Law Source: Section 2A-206; Section 2-206.

Definitional Cross References.

"Agreement": Section 1-201. "Contract". Section 1-201. "Delivery": Section 2B-102. "Merchant": Section 2B-102. "Notice". Section 2B-102. "Notice": Section 1-201. "Notifies". Section 1-201. "Party". Section 1-201. "Receive": Section 2B-102. "Standard form". Section 2B-102. "Term". Section 1-201.

Official Comments:

1. *Basic Coverage.* This Section deals with three issues involving offer and acceptance: general methods of acceptance, acceptances that vary the terms of the offer, and conditional offers or acceptances. 2. *Methods of Acceptance and Formation.* Subsection (a) follows Article 2-206(1). It allows acceptance of an offer by a variety of means, but also recognizes the right of the offeror to control the terms of the acceptance.

3. *Acceptance that Varies the Terms of an Offer.* Subsection (b) rejects the mirror image rule which permits a binding contract only if the acceptance fully matches the offer. As in Article 2, however, the acceptance must be an **acceptance;** no contract is formed by a counteroffer unless it is accepted.

Contract formation by an acceptances that vary the terms of an offer creates several conceptual and practical issues. The legal concepts must be fitted to commercial practice.

4. *Varying Terms: Material Variance.* Subsection (b) concerns how to distinguish cases of a contract formed by a varying acceptance and cases where the variance indicates that no contract is formed by the offer and acceptance. Material variance, either a conflict with a material term or a material modification of the offer, precludes formation. A contract requires a meeting of the minds. That does not occur when there is material disagreement on material terms. That rule protects both parties. What constitutes a material term or a material alteration of the offer depends on the context, including what the parties might reasonably expect to find in contracts in light of applicable trade use and course of dealing.

The rule does not preclude formation of a contract by conduct subject to the terms of Section 2B-209. Circumstances adequate to show agreement despite material conflict in the records exchanged by the

parties as a purported offer and acceptance correspond to the broad concept of contract formation outlined in Section 2B-202.

If a contract is formed, important issues center on what terms are applicable to the contract. By hypothesis, the records exchanged as an offer and acceptance materially diverge. Subsection (b)(1) contemplates two approaches to determining the terms of the contract. The first arises if one party agreed to the terms of the other. In that case, the terms of the accepted record control subject to the limitations in Section 2B-207 and 2B-208. Agreement can be manifested in any manner except that it cannot be found solely in the "acceptance" that contains a materially varying term. The second is where the exchanged offer and acceptance materially conflict, but a contract is formed solely by conduct. This places the relationship under Section 2B-209. .

5. *Varying Terms: Non-Material Variance.* If the offer and acceptance do not materially vary, they form a contract. The terms of the contract are the terms of the accepted offer. Subsection (b)(2), however, also allows for the introduction of non-material additional terms from the acceptance unless the offeror timely objects to those terms. This rule comes from existing Article 2. It does not apply to terms that provide conflicting treatment of the same subject matter.

6. *Conditional Offers and Acceptances.* As a matter of general contract law, a person has a right to state and insist on preconditions for acceptance of its offer. The most common conditional offer or acceptance is one that conditions its effect on adherence to all of its own contractual terms. No principle in contract law precludes a party from using such conditional offers.

Subsection (c) recognizes that these conditional statements are entitled to recognition. Subsection (d) provides a limit on this proposition. Conditional language in the standard terms of standard forms creates special problems in the "battle of forms" transaction in which either or both parties make the acceptance or offer expressly conditional on its specific contractual terms, but perform irrespective of acceptance of the condition. Subsection (d) treats this as a question involving the effectiveness of the conditional language.

Illustration 1. Purchaser sends a standard order form indicating that its order is conditional on the Licensor's assent to terms on the form. Licensor ships with an invoice conditioning the contract on assent to its terms. Purchaser accepts shipment. Here, neither party acted consistent with the language of condition. A contract exists based on conduct. The terms are governed by 2B-209.

Illustration 2. In Illustration 1, assume that Licensor refuses to ship, but informs Purchaser of the conditions of shipment. It does not ship until Purchaser agrees to terms. Until that occurs, there is no contract. If it occurs, the contract exists based on form agreed to.

Illustration 3. In Illustration 1, assume Licensor ships pursuant to a "conditional" form, but when the shipment arrives, Purchaser refuses it. In a telephone conversation, Licensor agrees to Purchaser's terms. Until that agreement, there is no contract; Purchaser acted in a manner consistent with its conditional language. When agreement occurred, that agreement sets out terms of the contract.

7. *Battle of Forms.* In resolving issues about the treatment of so-called battle of forms cases, this section must be considered in connection with Section 2B-209. Note 4 to that section presents a list of the questions that are asked to resolve such questions under this Article.

2B-204. OFFER AND ACCEPTANCE; ELECTRONIC AGENTS. In an automated transaction, the following rules apply:

(1) A contract may be formed by the interaction of electronic agents. A contract is formed if the interaction results in the electronic agents' engaging in operations that confirm or indicate the existence of a contract.

(2) A contract may be formed by the interaction of an electronic agent and an individual. A contract is formed if the individual has reason to know that the individual is dealing with an electronic agent and the individual takes actions or makes a statement that:

(A) the individual has reason to know will cause the electronic agent to perform, provide benefits, permit use or access that is the subject of the contract, or instruct a person or an electronic agent to do so; or

(B) the circumstances clearly indicate will constitute acceptance, regardless of other expressions or actions by the individual to which the electronic agent cannot react.

(3) The terms of a contract formed under paragraph (2) are determined under Section 2B-207 or 2B-208, as applicable, but do not include terms provided by the individual in a manner to which the electronic agent could not react.

(4) A party is bound by the operations of its electronic agent even if no individual was aware of or reviewed the agent's actions or their results.

Definitional Cross References

"Agreement": Section 1-201. "Automated transaction": Section 2B-102. "Contract": Section 1-201. "Electronic agent": Section 2B-102. "Information": Section 2B-102. "Informational Rights": Section 2B-102. "Party": Section 1-201. "Reason to know": Section 2B-102. Term": Section 1-201.

Official Comments:

1. The Section deals with two contexts: 1) interaction between a human and an electronic agent, and 2) an interaction between two electronic agents without human intervention. In both, the first premise is that the interaction can create a contract. In subsections (1) and (2) the second sentences describe specific instances within the general rule, but do not state the exclusive way of satisfying the rule.

Electronic methodology is in widespread use, but there are questions of under what circumstances agreement is inferred from behavior and of to what terms an electronic agent can agree. The following, although not within Article 2B scope, illustrates an aspect of the issue:

> **Illustration 1.** Tootie is an electronic system for placing orders for Home Shopping Network. When a customer dials the number, a voice comes on line instructing the customer to indicate a card number, the item number to be purchased, the quantity, the customer's location, and other data. This is done by striking keys and numbers on the telephone. Tootie automatically orders shipment. Ray calls Tootie and, after entering his card number, verbally states to Tootie that he will only accept the software being order if there is a 120 day "no questions" return policy. Otherwise: "I don't want the damn things." Tootie orders shipment.

There is a contract. The verbal addition or condition is ineffective. Stating conditions clearly outside the capability of the electronic agent to react does not vitiate the agreement reached by taking the steps needed to initiate the shipment. The verbal conditions are ineffective to alter the agreement since the Tootie system could not respond to the verbal condition.

> **Illustration 2.** User dials the ATT information system. A computerized voice states: "If you would like us to dial your number, strike "1", there will be an additional charge of $1.00. If you would like to dial yourself, strike "2". User states into the phone that he will not pay the $1.00 additional charge, but would pay .50. Having stated his conditions, User strikes "1". User states the name of the recipient of the call. The ATT computer dials the number, having located it in the database.

Under the circumstances, User's "counter offer" is ineffective; it could not be reacted to by the ATT computer. The charge for the use should include the additional $1.00.

2. As between electronic agents operations that signify a contract form an enforceable contract. The automated agents were selected or used by the parties to achieve these results and Article 2B acknowledges the efficacy of the choice. See Section 2B-202.

2B-205. FIRM OFFERS. An offer by a merchant to enter into a contract which is made in an authenticated record that by its terms gives assurance that the offer will be held open is not revocable for lack of consideration during the time stated. If a time is not stated, the offer is irrevocable for a reasonable time not exceeding 90 days. A term providing assurance that the offer will be held open which is contained in a standard form supplied by the party receiving the offer and used by the party making the offer is ineffective unless the party making the offer authenticates the term.

Uniform Law Source: Section 2A-205; Section 2-205.

Definitional Cross References.

"Authenticate". Section 2B-102. "Contract". Section 1-201. "Merchant". Section 2B-102. "Party". Section 1-201. "Record". Section 2B-102. "Standard form". Section 2B-102. "Term". Section 1-201.

Official Comments: This Section follows existing Article 2.

2B-206. RELEASES; SUBMISSIONS OF IDEAS.

(a) The following rules apply to releases of informational rights:

(1) A release in whole or in part is effective without consideration if:

(A) it is in a record to which the releasing party agrees, by manifesting assent or otherwise, and which identifies the informational rights released; or

(B) it is enforceable under estoppel, implied license, or other rules.

(2) A release continues for the duration of the informational rights released if the agreement does not specify its duration and does not require affirmative performance after the grant of the release:

(A) by the party granting the release; or

(B) by the party receiving the release, except for relatively insignificant acts.

(3) In cases not governed by subsection (a)(2), the duration of a release is governed by Section 2B-308.

(b) The following rules apply to submissions of information for the creation, development, or enhancement of information that are not made pursuant to an existing agreement calling for the submission:

(1) a contract is not formed and is not implied from the mere receipt of an unsolicited disclosure;

(2) engaging in a business, trade or industry that by custom or conduct regularly acquires ideas for the creation, development, or enhancement of information does not in itself constitute an express or implied solicitation of the information; and

(3C) if the recipient seasonably notifies the person making the submission that it maintains a procedure to receive and review submissions, a contract is not formed unless:

(A) the information is submitted and accepted pursuant to that procedure; or

(B) the recipient expressly agrees to terms concerning the submission.

(c) An agreement to disclose an idea creates a contract enforceable against the receiving party only to the extent if the idea as disclosed is confidential, concrete, and novel to the business, trade, or industry.

Definitional Cross References.

"Agreement". Section 1-201. "Information". Section 2B-102. "Informational rights". Section 2B-102. "License": Section 2B-102. "Party". Section 1-201. "Record". Section 2B-102. "Release". Section 2B-102.

Official Comments:

1. *General Rationale: Releases.* Releases are important in practice in all information industries. They are a form of a license, but are ordinarily less formally negotiated or established and frequently obtained with little or no consideration paid over to the releasing party. While a release is a license, it is a simple agreement not to sue, rather than a commercial transaction The term "release" is defined in Section 1-102.

2. *Enforceability.* Under subsection (a)(1) a release is enforceable without consideration, but places a limitation on that concept as an affirmative premise by focusing on a release contained in a record to which the releasing party manifested assent. This clarifies existing law, but does not alter other law making releases enforceable.

Releases commonly occur in "chat room" and "list service" systems in Internet. In these situations, it is common to indicate that participation in the service gives permission for the use of materials submitted. Arguably, these relationships are supported by consideration; this section makes clear that releases in such situations are enforceable based on assent to the record.

Illustration. West operates an on-line chat room. It uses comments of users in its monthly newsletter. The first time an individual joins the chat room, the screen stated that: "By participating in this on-line conversation, you grant West the right to use your comments as edited in subsequent publications in any medium." By joining the conversation, the participant releases its rights in its copyright comments for the purposes stated if the act of participating constitutes manifesting assent.

The section refers to assent to a record. This covers modern means of recording assent, such as by filming assent. The filmed assent is in effect no different from other acts. In both cases, the included act or signing authenticates the record.

3. *Idea Submissions.* Subsection (b) and (c) deal in a limited way with a problem for all of the industries to which this Article applies: submission of informational content not pursuant to an agreement. The sections provide that, if a procedure exists for receipt and review of such submissions to which the submitting party is referred, no contract exists unless the submission was pursuant to that procedure or compliance with the procedure was waived by the licensee. This leaves undisturbed a vast array of doctrines dealing with adequacy of consideration, equitable remedies, and the like, but clarifies the legal effect of the submission in contractual doctrine.

4. *Consideration* Subsection (c) adopts the approach of New York cases on whether a contract is formed in reference to idea submissions. If the idea that is a subject of the agreement is not in fact novel, this rule does not give the licensee a right to recover payments it has made, but does vitiate any future, executory obligations. The basic theory combines a view that a non-novel idea is not adequate consideration with a concept that the proponent of the idea who receives consideration represents that the idea it reveals has value and that this is not met in a case of a non-novel idea.

[B. Terms of Records]

2B-207. ADOPTING TERMS OF RECORDS.

(a) Except as otherwise provided in Section 2B-208, a party adopts the terms of a record, including a standard form, if the party agrees, by manifesting assent or otherwise, to the record:

(1) before or during the initial performance or use of or access to the information or informational rights; or

(2) at any time after the party has had an opportunity to review the record, if at the time performance or use commenced the party expected that the agreement would be represented in whole or in part by a record if the parties agreed to the record, but the party did not have an opportunity to review the record or the record had not been completed at the time the performance began or use commenced.

(b) Except as otherwise provided in Section 2B-208, if a party adopts the terms of a record, including a standard form, the terms of the record are the terms of the contract without regard to the party's knowledge or understanding of individual terms in the record. However, a term that fails to satisfy a requirement of this article or other law for enforceability is not enforceable.

Definitional Cross Reference:

"Agreement". Section 1-201. "Conspicuous". Section 2B-102. "Contract". Section 1-201. "Information": Section 2B-102. "Informational Rights": Section 2B-102. "Manifest assent." Section 2B-111 "Opportunity to review." Section 2B-112. "Party". Section 1-201. "Record". Section 2B-102. "Standard form". Section 2B-102. "Term". Section 1-201.

Official Comments:

1. *General Structure: Terms of Contract.* Article 2B deals with the terms of a contract, in three sections. Section 2B-207 and 2B-208 deal with cases involving a single record adopted by the parties. Section 2B-209 deals with cases where an offer and acceptance in records do not create a contract, but a contract exists because of the conduct of the parties.

2. *Adopting Terms: Enforceability.* Subsection (a) states the principle that if a party agrees or assents to a record, it adopts the terms of the record, including a standard form. .The section rejects in commercial transactions any rule that a term that is not unconscionable or induced by fraud may still be invalidated by a court. The principle adopted here is followed in the vast majority of modern cases. Absent unconscionability, fraud or similar conduct, commercial parties are bound by the records to which they assent and cannot later claim a failure to read the language presented.

Assent often not only refers to adopting the terms of the record. It also entails acceptance of the contractual relationship. See **Restatement (Second) of Contracts** 19.

3. *Adopting Terms: Knowledge.* It is not necessary that the adopting party actually read, understand, or negotiate the terms. This follows virtually universal law in the United States. In many situations, parties do not closely review or dicker about each term. The defense that "I did not read" the contract does not enable a party to avoid the effect of the terms of a record it adopted.

4. *Modes of Assent.* A party is bound by a record only if it agrees to the record, by manifesting assent or otherwise. There are three general methods of establishing adoption of a record.

One involves authenticating (signing) the record. This is a traditional means of adopting terms of a record, but has never been the sole method of doing so.

The second is conduct that indicates assent to a record or a contract. As defined in Section 2B-111, this focuses on objective manifestations of assent. Section 2B-111 adopts procedural safeguards requiring that the party have a fair an opportunity clearly delineated to review the terms before assenting and to reject the agreement if the terms are not acceptable. See Section 2B-112. A party cannot manifest assent to a form or other record unless it has had an opportunity to review that form before reacting. Except in contract modifications and situations contemplated by Section 2B-207(a)(2), an opportunity to review does not occur unless the party has a right to return the subject matter, refuse the contract, and obtain a refund of fees already paid (if any).

The third entails residual modes of assent, and follows current law in recognizing that structured options are inadequate to cover all situations in which it can be fairly said that a party agreed to a record. **5.** *Rolling or Layered Term Adoption.* While some contracts are formed and their terms delineated at a single point in time, in many transactions a rolling or layering process occurs. An agreement exists and terms are provided, clarified or introduced later or over time. Contract term definition is a process, rather than a single event. Subsection (a) rejects the idea that a contract and all of its terms must be formed at a single point in time.

See **Carnival Cruise Lines, Inc. v. Shute**, 111 S.Ct. 1522 (1991); **Hill v. Gateway 2000, Inc.,** 1997 WL 2809 (7th Cir. 1997). A rolling contract concept reflects commercial reality. Terms often are created by assent after beginning performance. Each party anticipates an enforceable record will be created and agreed to, but neither waits on performance until one is fully drafted. This section accommodates that process as well as the common practice of providing terms for assent at some point prior to the initial performance.

2B-208. MASS-MARKET LICENSES.

(a) A party adopts the terms of a mass-market license for purposes of Section 2B-207 only if the party agrees to the mass-market license, by manifesting assent or otherwise, before or during the initial performance or use of, or access to, the information or informational rights. However, a term does not become part of the contract:

(1) if it is unconscionable under Section 2B-110; or

(2) subject to Section 2B-301 with regard to parol or extrinsic evidence, if it conflicts with terms to which the parties to the license expressly agreed.

(b) If a party does not have an opportunity to review a mass-market license before becoming obligated to pay for the information and subsequently does not agree, by manifesting assent or otherwise, to the mass-market license after having that opportunity, the party has a right, on delivering all copies of the information or destroying the copies pursuant to instructions, to:

(1) a refund;

(2) reimbursement of any reasonable expenses incurred related to the return in obtaining the refund in and complying with any instructions of the licensor for return or destruction of the information or, in the absence of instructions, return postage or similar reasonable expenses in returning the information; and

(3) compensation for any foreseeable loss caused by the installation of information in order to view the license, including any reasonable expenses incurred in restoring the particular information processing system to its condition before the required installation, if:

(A) the information must be installed in an information processing system to enable review of the license; and

(B) the installation alters that information processing system or information contained in the system but does not return the system or information to its previous condition when the installed information is removed due to the rejection of the license.

AT THE NCCUSL ANNUAL MEETING, COMMISSIONER HENDERSON MADE A MOTION THAT THE ARTICLE 2B COMMITTEE SHOULD CONSIDER A PROPOSED DRAFT PROVISION OF PENDING REVISIONS OF ARTICLE 2. THE MOTION WAS NOT ACTED UPON BY THE COMMITTEE OF THE WHOLE, BUT THE DRAFTING COMMITTEE AGREED TO REVIEW THE PROPOSAL. THE DRAFT IS THE SUGGESTION OF THE ARTICLE 2 REPORTER AND HAD NOT BEEN CONSIDERED BY THE ARTICLE 2 COMMITTEE AT THE TIME THAT THIS ARTICLE 2B DRAFT WAS PREPARED. IT READS AS FOLLOWS:

2-105 Unconscionability.

.....

[(b) In a consumer contract [contract between an individual and a merchant], non-negotiable [non-negotiated] terms in a record which the [consumer][individual] has authenticated or to which it has agreed by conduct are unconscionable if:

(1) the consumer [individual] had no knowledge of them; and

(2) the term

(A) varies unreasonably from applicable industry standards or commercial practices;

(B) substantially conflicts with one or more negotiated terms in the agreement; or

(C) substantially conflicts with an essential purpose of the contract.

This subsection does not apply to a term disclaiming or modifying an implied warranty in accordance with another section of this article.]

Uniform Law Source: Restatement (Second) of Contracts 211.

Definitional Cross Reference:

"Contract": Section 1-201. "Information": Section 2B-102. "Information processing system": Section 2B-102. "Informational Rights": Section 2B-102. "License": Section 2B-102. "Licensor": Section 2B-102. "Manifest assent: Section 2B-111. "Mass-market license": Section 2B-102. "Party": Section 1-201. "Refund": Section 2B-102. "Term": Section 1-201.

Official Comments:

1. *General Approach.* This section deals with mass market (retail) contracts. Many mass-market licenses entail two separate agreements involving a three-party transaction: 1) the license between the remote publisher (informational rights holder) and the end user, and 2) the retail agreement between the end user and the retailer. These three party settings create important market-place benefits for the end user and establish contractual privity between the publisher and end user, but also present issues about treating the end user fairly. The three party deal is also dealt with in Section 2B-617.

This Section places procedural and substantive restrictions on mass-market licenses. The restrictions apply to all mass market forms. This Section should be read in connection with Section 2B-207 and with the requirements for manifesting assent in Section 2B-111. Adoption of the terms of a mass market license occurs only when the limitations stated in 2B-207 **and** the restrictions stated here are met.

The Section does not adopt the rules of **Restatement (Second) of Contracts** 211 which allow a court to invalidate terms that are not unconscionable if the court concludes that they are not within expectations of a party. Instead, the section responds directly to the policies that underlie the **Restatement** which are to prevent bizarre and oppressive terms (unconscionable) or terms that vitiate the basic deal (subsection (a)(2)). In the more than twenty years since it was first proposed, the **Restatement** has been adopted in less than ten states because it creates uncertainty on criteria that are not defined.

This Section is not limited to consumer transactions or to transactions involving so-called "shrink wrap" licenses. Subsection (a) deals with all retail transactions and all consumer transactions.

2. *Records Presented Prior to Payment.* If terms of a mass-market license are presented before a price is paid, the enforceability of a mass-market contract presents questions that have been presented to courts for years. Article 2B follows the vast majority of courts that enforce the standard form if the party manifests assents to the form. The fact that the terms are non-negotiable or may be a "contract of adhesion" does not invalidate them. It may, however, suggest a need for close scrutiny of *terms* under general standards of unconscionability. Section 208(a)(1) requires this scrutiny.

Ideas of assent must reflect the position of all parties in a retail license. In a typical transaction, the publisher does not agree to license under any terms other than those in its license. The other party can assent or can forego the transaction. So long as there is no fraud or unconscionable terms, a publisher (or other vendor) may choose the terms under which it markets its product and the terms that define the product itself.

3. *General Rules.* Subsection (a) sets out general rules for when the terms of a mass market license become the terms of the contract. These apply to both records presented for review prior to committing to the transaction with the retailer, and records presented at or before the first use of the information.

a. **Assent and Agreement.** A party is bound to the terms of a record if it agrees to the record. Agreement can be shown in various ways. One of these is by manifesting assent to the record. See **Restatement (Second) of Contracts 19, 211**. The idea of manifesting assent is that the party adopts the record by taking some action that objectively indicates agreement to the record. In addition, under Section 2B-111, a party cannot manifest assent unless it has had an opportunity to review the record. This requires that the record be reasonably available. It does not require that the party actually read the record.

b. **Unconscionability.** Even if a party adopts a record, this does not adopt terms that are unconscionable. The doctrine that disallows unconscionable terms allows courts to avoid bizarre and oppressive results in standard form contracting. How that theory evolves in modern markets for licenses of information requires judicial decisions. Unconscionability doctrine blends questions about the contracting process (procedural) with questions about the substantive terms (substantive). It

prevents abuse and unfair surprise. In an non-bargained market, this doctrine provides a safeguard against over-reaching.

The doctrine invalidates terms that are bizarre and oppressive and hidden in boilerplate language. For example, a term in a mass market license that default on the mass market contract for $50 software cross defaults on all other licenses between two companies may be unconscionable if there was no reason to expect the linkage of the small and the larger licenses. Similarly, a clause abrogating all responsibility for intentional wrongful acts buried in a license form violates public policy and, in addition to being unenforceable on that basis, might also be unconscionable.

Unconscionability doctrine requires a contextual analysis. It is not possible to fully describe the various situations in which it may apply. The doctrine is sufficiently flexible to consider underlying public policies and protection of public interests in free flow of information. Article 2B takes a neutral position on the federal policy issues in information transactions. Within that approach, issues about the relationship between a contract clause and underlying principles of free speech, free idea flow, and the like in mass markets are appropriate elements in an unconscionability analysis. Thus, for example, a contract term purporting to prevent the buyer of a publicly distributed magazine from quoting the magazine's observations about consumer products might be unconscionable.

In practice, however, the standards come from federal law. The fact that the contract is generally enforceable under Article 2B does not alter application of federal law concepts.

c. **Agreed Terms.** Subsection (a) creates a new premise that a mass market form cannot alter the terms agreed to between the parties to the license. This covers an issue discussed in the **Restatement (Second) of Contracts** 211 which allows a court to invalidate standard form clauses that vitiate the essential bargain of the parties while the reference to unconscionable terms deals with the other Restatement concern, which deals with the invalidation of surprising terms that are "bizarre and oppressive."

> **Illustration 1:** The librarian of University Libraries orders a copy of Zen Software's multimedia product for University's public network and agrees on a price for network use. The software is delivered for the agreed fee, but a mass market license limits use to a single user . University assents to the license without reading the clause. The single user term of the license is not part of the contract under (a) if the parties agreed to a network license.

3. *Case Law.* In single form cases, no appellate case law rejects the enforceability of mass market contracts and recent cases expressly support it. See **ProCD, Inc. v. Zeidenberg**, 86 F.3d 1447 (7th Cir. 1996); **Arizona Retail Systems, Inc. v. Software Link Inc.,** 831 F. Supp. 759 (Ariz. 1993). Compare **Vault Corp. v. Quaid Software Ltd.,** 847 F.2d 255 (5th 1988) (appellate court did not address contract issue). Cases are less clear in cases of conflicting forms (battle of forms) or transactions outside the mass market. See **Step-Saver Data Systems, Inc. v. Wyse Technology**, 939 F.2d 91 (3d Cir.1991); **Arizona Retail Systems, Inc. v. Software Link Inc.,** 831 F. Supp. 759 (Ariz. 1993). The cases do not contest the enforceability of standard forms in general..

4. *Forms presented after payment.* In modern commerce, licenses are often presented after a price is paid or committed to be paid to a retailer.

a. Distribution and Intellectual Property Rights. Distribution of digital information does not parallel that in the sale of goods. The differences lie in the intellectual property rights and the choices by the rights owner (publisher) which are to provide rights different (greater or lesser) from those created if it simply sold copies to a distributor for resale to an end user.

In most transactions where a license is presented to the end user after it acquires a copy from a retailer, the license is between the *copyright owner* and the end user, rather than between the end user and *the retailer*. In this three-party setting (end user, retailer, copyright owner), the enforceability of the post-payment license is important to the end user. The form establishes *for the first time* a relationship between the copyright owner and the end user that may be central to the end user's right to use the information.

In establishing a mass-market distribution system, an informational rights owner may give its distributors either (1) ownership of a copy and a right to sell copies of its work to others, or (2) a license to license copies to others. Intellectual property law supports either choice. It also provides that, if a license is created and the distributor exceeds the license, the eventual transferee (even if in good faith) is not protected as a bona fide purchaser. See **Microsoft Corp. v. Harmony Computers & Electronics, Inc.,** 846 F. Supp. 208 (ED NY 1994); **Major League Baseball Promotion v. Colour-Tex,** 729 F. Supp. 1035 (D. N.J. 1990); **Microsoft Corp. v. Grey Computer**, 910 F. Supp. 1077 (D. Md. 1995); **Marshall v. New Kids on the Block**, 780 F. Supp. 1005 (S.D.N.Y. 1991).

The end user is often benefited by a license rather than a sale transaction. A sale creating ownership of a copy of a work (book, computer program or other work) does not give the owner a number of

rights that it may desire. It does not give the right to make multiple copies, to make a public display of the work, to make derivative works from the copy, or to do other significant things. Licenses in the mass market and otherwise typically create rights that go beyond the rights that arise in the event of mere sales of copies.

In this setting, both the publisher and the end user have an interest in the license being enforceable. If the license is not enforceable, the end user receives few if any rights to use the acquired information and has no rights against the remote publisher in warranty or otherwise in the absence of rules that vitiate all concepts of privity. The end user contracted solely with the retailer. On the other hand, the publisher that chooses this distribution method has an interest in the enforceability of the license because that license defines the product that it allowed into the market.

b. Refund Rights. In post-retail purchase licenses, two issues are important. One involves dealing with prevention of bizarre and oppressive terms. That issue is identical to that presented in pre-retail purchase transactions. The second involves whether a licensee has a real opportunity to review and accept or reject the license with the remote publisher.

Subsection (b) deals with this second issue. It creates a refund and reimbursement right that places the retail end user in a situation whereby it can exercise a meaningful choice on a post-retail purchase license. The end user must be given a cost free right to say no to the proposed license. This does not mean that the end user can reject the license and use the information. What is created is a right to be in a situation equivalent to what would exist if the license were presented for adoption before the retail acquisition of the copy. If there is no assent to the contract, the end user can return itself to the place that it was in before acquiring the copy and reviewing the license.

6. *Intellectual Property Issues.* Important federal policy issues can arise in distribution of information in a mass market. Article 2B adopts a neutral position on these issues. See discussion in notes to 2B-105.

2B-209. TERMS WHEN CONTRACT FORMED BY CONDUCT.

(a) Except as otherwise provided in subsections (b) and (c), if a contract is formed solely by conduct of the parties, in determining the terms of the contract, a court must consider the terms and conditions to which the parties expressly agreed, any applicable course of performance, course of dealing, or usage of trade, the conduct of the parties, the information or informational rights involved, the supplementary terms provided by any other provision of [the Uniform Commercial Code] which apply to the transaction, and all other relevant circumstances.

(b) If there is no agreement on a material element of scope or if there is a material disagreement about a material element of scope, a contract is not formed by conduct.

(c) This section does not apply if the parties authenticate a record of the agreement, a party adopts the record of the other party, or there was an effective conditional offer under Section 2B-203 to which the party to be bound agreed, by manifesting assent or otherwise.

Uniform Law Source: Section 2-207. Substantially revised.

Definitional Cross References.

"Agreement": Section 1-201. "Authenticate": Section 2B-102. "Contract": Section 1-201. "Court": Section 2B-102. "Information": Section 2B-102. "Informational Rights": Section 2B-102. "Party": Section 1-201. "Record": Section 2B-102. "Scope": Section 2B-102. "Term": Section 1-201.

Official Comments:

1. *General Effect.* This Section deals with cases where a contract is formed by conduct. The Section does not apply if the parties conditioned the existence of a contract on agreement to terms that were not in fact later agreed upon. In that case, despite the conduct, Section 2B-203(e) applies.

Contracts formed by conduct can arise in various settings. One setting is where the parties begin and complete performance without ever having reduced their agreement to writing or, even, making a specific offer and acceptance. Another involves a "battle of forms" which did not result in an effective offer and acceptance and in which neither party adopted or authenticated a record signifying the terms of agreement.

In determining what are the terms of contracts created by conduct, this Section rejects the so-called "knock-out" rule in 2-207(c). It requires that the court determine the terms of the contract by considering all of the commercial circumstances, including the nature of the conduct, the informational rights involved, and applicable trade usage or course of dealing. This, of course, includes the default rules of this Article.

If the exchanged records create a contract, or one party agrees to terms proposed by the other in a record or otherwise, this section does not apply. Subsection (c) confirms that result. Subsection (b) deals with lack of agreement on material terms concerning scope.

2. *Interpret based on Context.* Subsection (a) directs attention to the entire context including the terms of exchanged records and the nature of the intellectual property rights held by the licensor or licensee. This conforms to the basic UCC theme of practical construction of a relationship. See **Restatement (Second) of Contracts** 202(1) (2) (1981); 2 **Farnsworth, Contracts** 7.10 (1990).

Where conduct, rather acceptance of an offer, creates the contract, **a priori** or formalistic rules cannot account for the contextual nuances that exist in a rich environment of transactional practice. Subsection (a) thus rejects the "knock-out" rule which requires that a court apply a set formula. Any rigid rule needlessly restrains courts from more generally determining the intent of the parties. Since Article 2B deals with transactions the vast majority of which are not now governed by the U.C.C., This rule allows courts to continue existing practice, rather than impose an inappropriate legal regime on the contract interpretation process.

3. *Battle of Forms and Conduct.* The battle of standard forms deals with a case where the parties exchange forms, but ignore those forms in determining to perform or not. The rule in subsection (a) looks to the entire circumstances in such cases, regardless of which form was first received or sent.

Illustration 1: In response to a standard form from DuPont, Developer ships software subject to a standard form invoice. The two forms disagree on warranties and the exchange does not in itself form a contract. Whether the contract that is formed by conduct contains warranty terms depends on the court's consideration of the entire context, including the Article 2B default warranties and established trade use or course of dealing.

Illustration 2: Developer sends a letter, rejecting the DuPont warranty terms, but ships without obtaining assent to its terms or precluding use of the software without such assent. Determining what terms govern poses a difficult, but ordinary interpretation issue about the intent of the parties.

4. *Battle of Forms: Integrated Result.* To be within this Section, the records of the parties must not establish a contract. Thus, the overall impact of this Section on battle of forms transactions requires consideration of this Section and of Section 2B-203. There are two different scenarios to be considered.

a. *Varying Terms.* The first situation involves a case in which forms are exchanged, but neither form is made expressly conditional on acceptance of its terms in full. Under these conditions, Section 2B-203 applies and Section 2B-209 provides a back-up. The analysis involves answering several questions.

1). Ask first: do the terms of the offer and acceptance vary? If not, a contract is formed based on the records.

2). If there is a variance, is the variance material? Section 2B-203 permits a contract formed by an offer and acceptance with varying terms unless the variance is material. If it is not material, a contract is formed based on the offer and non-material additional terms in the acceptance.

3). If there is a material variance, a contract based on the records is still possible if one party "accepted" the terms of the other party's offer.

4). If there is a material variance and no acceptance, but a contract is formed by conduct, Section 2B-209 determines its terms based either on a general assessment of the context.

b. *Conditional Offers.* If the terms of the offer or acceptance vary and one or both are conditional on acceptance of their terms, a different analysis applies. The basic premise is that a party has a right to condition its offer or acceptance and that the conditions are enforced unless waived.

1). Ask first: are either or both the offer or acceptance made conditional on assent to their own terms? If yes, Section 2B-203(c) applies.

2). Under 2B-203(c), ask whether the conditions are effective or whether they have been waived. Waiver can be inferred on any basis, but in standard form settings, waiver is assumed if the party does not act in a manner that is *consistent* with its own conditions.

3). If the conditions were waived, analysis reverts to the general analysis of conflicting terms: a) is the conflict material; b) if yes, did conduct create a contract?

4). If the conditions are effective (e.g., not waived), ask: did the other party accept the conditional offer? If yes, the contract is formed based on the conditional terms.

5). If there was no acceptance of the conditional offer, no contract is formed based on the records. If a contract is formed based on conduct, Section 2B-209 applies.

5. *Contracts by Records.* If a party conditions its agreement to a contract on the other party's assent to its terms, that condition should be enforced. Contract law does not impose a contract on unwilling parties nor does it prevent a party from conditioning the terms on which it will do business. This Section recognizes that, where an effective condition was asserted and agreed to by the other party, the terms

of that conditional offer or counter offer override the provisions of this section. Simply stated, the contract was formed on one party's terms and courts should not disturb that result.

Similarly, under subsection (c) this section is inapplicable if a party signs and accepts a contract embodied in a record of the other. This Section applies only where the contract is based merely on conduct.

Authenticated (signed) records supersede conduct subject of course to parole evidence issues.

7. *Scope of License.* In information products, the contract terms relating to scope of use define the product being licensed. The same subject matter (e.g., one copy of software) has entirely different value and substance depending on what rights are granted. That being true, this section gives special deference to scope issues. It provides that the lack of an agreement as to a material element of scope, or a material disagreement, precludes the formation of a contract by conduct. In the absence of contrary agreement, the information provider can define what it is providing.

The other party cannot resort to a court to obtain that product which it failed to obtain from the licensor by negotiation. A vendor who provides a consumer version of software cannot be forced to have given an unlimited, license in the software for development and other use simply because a competing form stated terms that conflict with the consumer restriction. Unlike warranty and similar terms, scope terms define the product being provided (e.g., multi-user or single user license). Additionally, it is only the licensor who is aware of what can be granted (e.g., it holds rights to a screen play only for use in television).

PART 3

CONSTRUCTION

[A. General]

2B-301. PAROL OR EXTRINSIC EVIDENCE. Terms with respect to which confirmatory records of the parties agree or which are otherwise set forth in a record intended by the parties as a final expression of their agreement with respect to such terms as are included therein may not be contradicted by evidence of any prior agreement or of a contemporaneous oral agreement but may be explained or supplemented by:

(1) course of performance, course of dealing, or usage of trade; and

(2) evidence of consistent additional terms unless the court finds the record to have been intended as a complete and exclusive statement of the terms of the agreement.

Uniform Law Source: Section 2A-202; Section 2-202.

Definitional Cross Reference:

"Agreement": Section 1-201. "Court": Section 2B-102. "Record": Section 2B-102. "Term": Section 1-201.

Notes: Follows current Article 2.

2B-302. COURSE OF PERFORMANCE OR PRACTICAL CONSTRUCTION.

(a) Where the contract involves repeated occasions for performance by either party with knowledge of the nature of the performance and opportunity for objection to it by the other, any course of performance accepted or acquiesced in without objection shall be relevant to determine the meaning of the agreement.

(b) The express terms of an agreement and any course of performance, as well as any course of dealing and usage of trade, shall be construed whenever reasonable as consistent with each other, but when such construction is unreasonable express terms control course of performance, course of dealing and usage of trade; course of performance controls both course of dealing and usage of trade; and course of dealing controls usage of trade.

(c) Subject to Section 2B-303 and 2B-605, course of performance shall be relevant to show a waiver or modification of any term inconsistent with such course of performance.

Uniform Law Source: Section 2A-207; Section 2-208; Section 1-205. Revised.

Definitional Cross References.

"Agreement": Section 1-201. "Contract": Section 2B-102. "Party": Section 1-201. "Term": Section 1-201.

Official Comments: Conforms to Article 2.

2B-303. MODIFICATION AND RESCISSION.

(a) An agreement modifying a contract within this article needs no consideration to be binding.

(b) An authenticated record that excludes modification or rescission except by an authenticated record cannot otherwise be modified or rescinded. In a standard form supplied by a merchant to a consumer, a term requiring an authenticated record for modification of the contract is not enforceable unless the consumer manifests assent to the term.

(c) The requirements of Section 2B-201 must be satisfied if the contract as modified is within its provisions.

(d) An attempt at modification or rescission which does not satisfy the requirements of subsection (b) or (c) may operate as a waiver if the provisions of Section 2B-605 are met.

Uniform Law Source: Section 2A-208; Section 2-209.

Definitional Cross References.

"Agreement". Section 1-201. "Authenticate". Section 2B-102. "Consumer". Section 2B-102. "Contract". Section 1-201. "Merchant". Section 2B-102. "Record". Section 2B-102. "Standard form". Section 2B-102. "Term". Section 1-201.

Official Comments:

This Section follows existing Article 2-209 except for the use of "manifest assent" regarding the use of a no modification term in a consumer contract.

2B-304. CONTINUING CONTRACTUAL TERMS.

(a) Terms of a contract involving successive performances apply to all performances unless the terms are modified in accordance with this article or the contract, even if the terms are not displayed or otherwise brought to the attention of the parties with respect to each successive performance.

(b) If a contract provides that its terms may be modified as to future performances by compliance with a described procedure, a change proposed in good faith pursuant to that procedure becomes part of the contract if:

(1) the procedure reasonably notifies the other party of the change; and

(2) in a mass-market transaction, the procedure permits the other party to terminate the contract as to future performance if the modification is of a material term and such party in good faith determines that the modification is unacceptable.

(c) The parties by agreement may determine the standards for reasonable notice unless the agreed standards are manifestly unreasonable in light of the commercial circumstances.

Definitional Cross References.

"Agreement": Section 1-201. "Contract": Section 1-201. "Good faith": Section 2B-102. "Mass-market license": Section 2B-102. "Notice": Section 1-201. "Notifies": Section 1-201. "Party": Section 1-201. "Term": Section 1-201. "Termination": Section 2B-102.

Official Comments:

1. *Continuing Terms.* Subsection (a) states the simple principle that contract terms, if enforceable, cover all contractual performance. This principle applies in any case where the subsequent performances are covered by the prior agreement. **2.** *Modifications: General Issue.* Subsection (b) addresses a common practice in online and other continuing contracts, such as outsourcing arrangements. In these long term contracts, frequent changes occur in the terms of service; separate negotiation of each change is often not feasible or desired by the parties. Common practice entails posting changes in a particular location or file and providing that the posted changes are effective when posted or at a later point in time.

Subsection (b) specifies one method for making changes in on-going relationships but does not preclude enforceable modifications based on other law or circumstances. For example, a signed modification is effective. Similarly, under general common law, principles of waiver (see, e.g., Section 2B-605) and on course of performance (Section 2B-302) also deal with enforceability.

What constitutes an effective modification hinges on agreement, but changes in terms are routinely found based on objective indicia of assent, such as awareness or notice, coupled with behavior not objecting to the changes in terms or performance. For example, even in a fixed term mortgage, federal rules allow unilateral changes in consumer contracts if the changes meet any of several criteria, including that either the change benefits the consumer or makes an "insignificant change" to the contract. FRB **Regulation Z**, 12 CFR § 226.5b. The contracts covered here are often subject to termination at will by either party and present a clearer case to allow non-material modifications.

3. *Contractual Authorization and Notice.* Subsection (b) describes a safe harbor indicating that modifications that comply are enforceable. This does not preclude other methods.

The approach in subsection (b) requires an agreement authorizing the modification procedure and that the procedure entail notification of the other party. What constitutes notification varies depending on the circumstances. In many cases, reasonable notification requires notification before the change is effect, but in some emergency situations, notice that coincides with the change or follows the change would be sufficient (e.g., blocking access to a virus infected site, or a change in the access codes required for access). See 12 CFR 205.8(a)(2) as an example. A procedure that calls for posting changes in an accessible location of which the other party is aware will ordinarily satisfy this section.

4. *Mass-Market Transactions.* Subsection (b)(2) modifies the safe harbor provision in the case of a mass-market transaction. In this situation, the procedure must not only have been agreed to and provide reasonable notification, it must permit the licensee an opportunity to withdraw as to future performance. This additional restriction is not appropriate in general commercial practice where by prior agreement the parties may provide that they are bound by good faith changes proposed by the other party.

The termination right extends only to changes that are material and adverse to the licensee. Price is a material term in all cases. Various other changes may be material matters in the on-going relationship. Of course, a reduction in service charges does not require a right to terminate.

Withdrawal is without penalty, but the mass market licensee must, of course, perform the contract to the date of withdrawal (e.g., pay all sums due at that time). In many mass-market contracts that entail continuing performance, the contract itself may be subject to termination at will under Section 2B-308. Subsection (b) does not alter that result.

5. *Changes in Content.* This Section deals with changes in contract terms and does not cover changes in the content made available under an access contract, such as one involving a multifaceted database. In an access contract the basic agreement grants rights to materials as changed and modified by the licensor over time. Thus, unless an express contract term provides otherwise, a decision to add, modify, or delete an element of the databases made available does not modify the contract, but merely constitutes performance by the licensor and is not within this subsection.

2B-305. PERFORMANCE UNDER OPEN TERMS; TERMS TO BE SPECIFIED; PERFORMANCE TO PARTY'S SATISFACTION.

(a) If a performance obligation of a party cannot be determined from the agreement or from other provisions of this article, the party shall perform in a manner that is reasonable in light of the commercial circumstances existing at the time of agreement.

(b) An agreement that is otherwise sufficiently definite to be a contract is not invalid merely because it leaves particulars of performance to be specified by one of the parties. If a term is to be specified by a party, the following rules apply:

(1) Specification must be made in good faith and within limits set by commercial reasonableness.

(2) If a specification to be made by one party substantially affects the other party's future performance but is not seasonably made, the other party:

(A) is excused for any resulting delay in its performance; and

(B) may perform, suspend performance, or treat the failure to specify as a breach of contract.

(c) Except as otherwise provided in subsection (d), an agreement that provides that the performance of one party is to be to the satisfaction or approval of the other requires performance sufficient to satisfy a reasonable person in the position of the party that must be satisfied.

(d) Performance must be to the subjective satisfaction of the other party if:

(1) the agreement expressly so provides, such as by stating that the satisfaction or approval is to be in the "sole discretion" of the party, or words of similar import; or

(2) the performance is for informational content to be evaluated in reference to aesthetics, market appeal, subjective quality, suitability to taste, or similar characteristics.

Uniform Law Source: Section 2-305; Section 2-311; Restatement 228. Revised.

Definitional Cross References.

"Agreement": Section 1-201. "Contract": Section 1-201. "Delivery": Section 2B-102. "Good faith": Section 2B-102. "Informational content": Section 2B-102. "Party": Section 1-201. "Term": Section 1-201.

Official Comments:

1. *Open Terms.* Subsection (a) and (b) bring together rules relating to open terms under current Article

2. *Performance to the Satisfaction of a Party.* Subsection (c) and (d) focuses on cases where performance is to be to the satisfaction of the other party, a common contractual arrangement in information industries. Consistent with the Restatement (Second) of Contracts § 228, the general interpretation of such clauses requires satisfaction measured under an objective, reasonable man standard. However, also as recognized in the **Restatement**, there are many cases where a subjective standard is appropriate. Subsection (d) provides guidance for determining when the subjective standard is appropriate. The issue is especially important since a factor that distinguishes the information industries is that many information products focus on aesthetics and marketability, rather than the capability of performance. Here, a "to the satisfaction clauses" creates a subjective standard, rather than one defined by reference to a reasonable person test. The objective standard is more appropriate in cases involving functional characteristics of computer programs.

3. *Contractual Language.* The choice between objective and subjective standards, of course, can be controlled by express contract terms. Subsection (d)(1) provides safe harbor language, indicating what language achieves a subjective satisfaction standard.

2B-306. OUTPUT, REQUIREMENTS, AND EXCLUSIVE DEALING.

(a) A term that measures the quantity or amount of use by the output of the licensor or the requirements of the licensee means such actual output or requirements as may occur in good faith. No quantity or amount of use unreasonably disproportionate to a stated estimate or, in the absence of a stated estimate, to any normal or otherwise comparable prior output or requirements may be tendered or demanded. However, this limitation does not apply if the party in good faith has no output or requirements.

(b) A lawful agreement for exclusive dealing in the information or informational rights concerned imposes an obligation on a licensor that is the exclusive supplier to use good-faith efforts to supply the information and on a licensee that is the exclusive distributor to use good-faith efforts to promote the information commercially if the value received by the other party substantially depends on that performance.

Uniform Statutory Source: Section 2-306.

Definitional Cross References.

"Agreement". Section 1-201."Good faith". Section 2B-102. "Information". Section 2B-102. "Informational Rights": Section 2B-102. "Licensee". Section 2B-102. "Party": Section 2-102. "Value": Section 2-102.

Official Comments:

1. *Out-put and Requirements.* Subsection (a) follows existing Article 2. In practice, however, many information transactions within its scope do not involve issues about "quantity" in the same way that sales (or leases) entail that issue. Courts must recognize and adjust their approach to this fact. A prime characteristic of information as a subject matter of a transaction is that information can be reproduced in relatively unlimited numbers; the goods on which copies are made are often the least significant aspect of a commercial deal. Rather than supply needs or sell output, the typical license gives a right to use or reproduce the information subject to an obligation to pay royalties based on the volume or other measurable quantity figure.

2. *Exclusive Dealing.* Subsection (b) integrates the various bodies of law that pertain to exclusive dealing relationships in information. Unlike for goods, the typical case here does not necessarily entail production and delivery of copies for resale by the other party. Article 2-306 creates a best efforts rule for goods. That rule, however, is not the law in any other field governed by Article 2B. This Section adopts a good faith effort standard: honesty in fact and adherence to commercial standards of fair dealing. This allows courts to draw appropriate balances in light of the commercial context and the existing traditions of that context in the atypical case where the contract is silent on the issue.

[B. Interpretation]

2B-307. INTERPRETATION OF GRANT.

(a) A license grants:

(1) the right to use the information or informational rights that are expressly described; and

(2) all informational rights within the licensor's control which are necessary in the ordinary course to exercise the expressly granted contractual rights.

(b) A license contains an implied limitation that the licensee shall not exceed the expressly granted contractual rights or exercise informational rights in the information other than those

described in subsection (a). However, use of the information or informational rights in a manner inconsistent with this implied limitation is not a breach of contract if the use would be permitted under applicable law in the absence of the limitation.

(c) An agreement that does not specify the number of permitted users permits a number of users which is reasonable in light of the informational rights involved and the commercial circumstances existing at the time of agreement.

(d) Except as otherwise provided under informational rights law, neither party is entitled to any rights in improvements or in modifications to the information made by the other party after the license becomes enforceable. A licensor's agreement to provide new versions, improvements, or modifications after acceptance of the completed information requires that the licensor provide new versions, improvements or modification as developed from time to time and made generally commercially available by the licensor.

(e) Neither party is entitled to receive copies of source code, object code, schematics, master copy, or design material, or other information used by the other party in creating, developing, or implementing the information.

(f) Terms dealing with the scope of an agreement must be construed under ordinary principles of contract interpretation in light of the informational rights and the commercial context. In addition, the following rules of interpretation apply:

(1) A grant of "all possible rights and for all media", "all rights and for all media now known or later developed", or a grant in similar terms, includes all rights then existing or later created by law, and all uses, media, and methods of distribution or exhibition whether then existing or developed in the future, whether or not anticipated at the time of the grant.

(2) A grant of an "exclusive license", or a grant in similar terms, means that for the duration of the license the licensor will not exercise, and will not grant to any other person, rights in the same information or informational rights within the scope of the exclusive grant. Further, the licensor affirms that it has not previously granted such rights in a contract in force when the licensee's rights begin.

Definitional Cross References.

"Agreement". Section 1-201. "Contract": Section 1-201. "Copy": Section 2B-102. "Information": Section 2B-102. "Informational rights": Section 2B-102. "License". Section 2B-102. "Licensee". Section 2B-102. "Licensor". Section 2B-102. "Party": Section 1-201. "Receive": Section 2B-102. "Rights": Section 1-201. "Scope": Section 2B-102. "Term": Section 1-201.

Official Comments:

1. *Implied Licenses.* The subsection (a) deals with the appropriate contract interpretation where rights not expressly granted are essential to the licensee's use of the information in a manner consistent with the expressly granted rights. Subsection (a) adopts the reasonable interpretation that the affirmative grant includes all necessary rights to use that grant, to the extent that these are within the control of the licensor. For example, a license to use a film clip in a CD ROM product conveys the right to crop or modify the size of the clip to fit the media unless a right to make such modifications is expressly excluded. A grant of a license in software conveys the right to use functions provided in the software in the ordinary course to modify that software. The implied rights, however, relate only to materials provided to the party; they do not require a transfer of additional materials (such as source code), unless that transfer was agreed to by the parties. Contract terms precluding such rights are effective.

2. *Exceeding the Grant.* Subsection (b) deals with what interpretation is placed on a grant "to do X." Under current law, it is clear that uses of licensed information outside the express scope of a license breach the contract if the scope is defined in terms of "to do only X" or otherwise expressly precludes the use. If the word "only" does not appear, the cases are less clear; some cases suggest that the omission of the word means that there is no contract breach if the licensee exceeds the grant. Other cases hold that federal policy requires interpretation of a copyright license that holds that any use not expressly granted is withheld. A rule that hinges on the use of the word "only" provides a true trap for unwary drafters and unwary licensees. It is rejected in this section.

Subsection (b) adopts the ordinary commercial understanding that an affirmative grant implicitly excludes uses that exceed or are not otherwise within the grant. The implied limitation, however, is not as strong as an express contract term of limitation. It does not yield a breach of contract if the use would have been permitted by law in the absence of the implied limitation. Thus, scholarly use of a quotation from a licensed material not subject to trade secrecy restraints, if a fair use, would not conflict with the implied limitation. However, even if a grant does not use the magic word "only" and gives a right to perform a motion picture at a designated location, a licensee that makes multiple copies for sale

violates the copyright and breaches the contract. A grant to use a work in Peoria implies the lack of a contract right to do so in Detroit.

> **Illustration 1:** EXL licenses copyrighted software to Dangerfield. The license is silent on reverse engineering and consumer use, but gives Dangerfield the right to use the software in the 1000 person network. Dangerfield disassembles the software to examine the code. Also, an employee uses the software for personal (consumer) purposes. Under subsection (b), the consumer use is authorized if it would be a fair use in the absence of the implied limit. The copies made for reverse engineering purposes involve the same analysis.

3. *Number of Users.* Subsection (c) uses a commercial reasonableness test to deal with cases where a license fails to specify the number of users that are permitted for the particular information. In some cases, especially in the mass market, a single simultaneous user limitation could be assumed for a computer program. In other contexts, multi-use or network use concepts are more appropriate. The section guides a court, and the parties, by making reference to commercially reasonable assumptions the context, including the intellectual property rights involved.

4. *Modifications.* As a basic principle a party receives no right in contract to subsequent modifications made by the other party, nor is access to typically confidential material. Arrangements for improvements and source code or designs constitute separate valuable relationships handled by express contract terms, rather than presumed away from their owner by the simple fact of forming a general contract.

> **Illustration 2:** Party A licenses B to use A's robotics software. Three months after the license is granted, Party A develops an improved version of the software. Party B has no right to receive rights in this improved version unless the agreement expressly so provides.

> **Illustration 3:** In the foregoing license, two years later, Party B's software engineers discover several modifications that enhance its performance. Party A is not entitled to these modifications unless the license expressly so provides. However, the modifications may create a derivative work under copyright law and a question exists about whether the license granted the right to make such a derivative work.

5. *Grant Clauses.* Subsection (f) states the general principle that ordinary commercial contract principles apply to interpreting a grant. This resolves questions of whether, under state law, policy considerations require an interpretation that precludes conveyance of rights unless express in the agreement. As a state law principle, of course, it is subject to contrary federal policy which, some courts hold, requires restrictive interpretation in favor of the licensor to protect intellectual property rights.

Subsection (f) (1) provides guidance for whether (when) a license grants rights only in existing media or methods of use of information or whether it extends to future uses. It adopts the majority approach. Ultimately, interpretation of a grant in reference to whether it covers future technologies is a fact sensitive interpretation issue. But use of language that implies a broad scope for the grant without qualification should be sufficient to cover any and all future uses. This is subject to the other default rules in this Article, including for example, the premise that the licensee does not receive any rights in enhancements made by the licensor unless the contract expressly so provides.

2B-308. DURATION OF CONTRACT. If an agreement does not specify its duration, to the extent allowed by other law, the following rules apply:

> (1) Except as otherwise provided in paragraph (2) and Section 2B-206(a), the agreement is enforceable for a time reasonable in light of the commercial circumstances but may be terminated as to future performances at will by either party during that time on reasonable notice to the other party.
>
> (2) The duration of contractual rights to use licensed information or informational rights is a time reasonable in light of the licensed informational rights and the commercial circumstances, but subject to cancellation for breach the duration is perpetual as to the contractual rights and contractual use restrictions if:
>
> > (A) the license is a software contract that transfers ownership of a copy or delivery of a copy for a fee the total amount of which is fixed at or before the time of delivery of the copy; or
> >
> > (B) the license authorizes the licensee to integrate the licensed information or informational rights into a product intended for distribution or public performance by the licensee.

Uniform Law Source: Section 2-309(1)(2).

Definitional Cross References.

"Agreement". Section 1-201. "Cancellation". Section 2B-102. "Contract": Section 1-201. "Contractual use restriction": Section 2B-102. "Copy". Section 2B-102. "Delivery". Section 2B-102. "Information". Section 2B-102. "Informational rights": Section 2B-102. "License". Section 2B-102. "Licensee". Section

2B-102. "Notice". Section 1-201. "Party". Section 1-201. "Rights". Section 1-201. . "Software contract". Section 2B-102.

Official Comments:

1. *Basic Scope and Theme.* This Section follows current Article 2 and common law, but provides for several cases in which licensees receive greater durational assumption than under existing law.

The section applies to agreements that do not specify their duration. The basic policy is that a person making an open-ended commitment should be held to performance over a time that is reasonable, but not be placed in a position of perpetual servitude. Consistent with Article 2 and common law, the basic rule is that the contract in such cases is subject to termination at will on reasonable notice. Subsection (2) describes cases in which, as to duration of a license, the term is presumed to be perpetual.

The section assumes that there is an agreement. In some cases, a failure to agree on duration will, like failure to agree on any other scope provision, indicate that no contract exists. In addition, the section does not apply simply because a record that documents the agreement is silent. Agreement refers to the entire bargain of the parties, including oral agreements, trade use, and course of dealing, any one of which might provide a defined duration.

The Section does not deal with contracts that define their duration, even if those terms do not specify a fixed date. Thus, a license for "the life of the edition" or "for so long as the work remains in print" defines the duration as does a contract term of, for example, ten years. On the other hand, decisions under Article 2 rule for commitments to "lifetime" service or "perpetual" maintenance, provide guidance on whether that language in a services obligation creates a definite term.

2. *Standard for Termination: Reasonable Time.* The basic rule is that in the absence of terms on duration, the duration of a contract is presumed to be a "reasonable" time. The reasonable time standard allows the parties and the court, if needed, to make determinations of what duration is appropriate in light of the commercial context.

Common law and Article 2 likewise make indefinite contracts subject to termination at will on reasonable notice to the other party. This allows a non-judicial method of ending the contract. Termination does not end all obligations or rights, including rights that vested based on prior performance. Which rights these include, of course, depends on the terms of the agreement.

In some cases, what constitutes a reasonable term can be determined by reference to other law. In this field, there are various federal policy considerations that affect the duration of licenses either by direct rule or by indirect influence on determining what is a reasonable time. Thus, a patent license that does not state its term can reasonably be presumed as extending for no more than the life of the patent. A similar premise exists for an indefinite copyright license.

3. *Effect of Termination.* Termination cancels executory obligations, except for contractual use restrictions. It does not end or otherwise affect rights that are vested based on prior performance. Thus, for example, assume a license for software that would be perpetual under subsection (2), but with respect to which the licensor agrees to an indefinite obligation to provide telephone support to the end user. The successive performances in that support obligation are under subsection (1). If the support provider terminates that obligation, it can end the executory obligation to provide support. That does not, however, alter the rights to use vested in the license.

4. *Perpetual Licenses.* Paragraph (2) differs from Article 2 and common law by presuming a perpetual term for two types of licenses. The first is a license associated with the sale or delivery of a copy of software. This rule corresponds to software licensing in general. The perpetual term assumption does not apply to services, such as ancillary support obligations, which are governed under the general reasonable time presumption. It also does not apply where the licensee has an on-going obligation to deliver affirmative performances to the other party.

The second situation deals with cases where the licensed information is intended to be incorporated into a product for third parties. The rule recognizes the reliance concerns that would be affected by a termination right.

2B-309. RIGHTS TO INFORMATION IN PARTY GIVING ACCESS.

(a) Between merchants, the rules of this section apply if

(1) one party is given access to the confidential commercial, scientific, or technical information of the other party and the agreement obligates the party to store handle or process the information;

(2) the party given access has reason to know that the information is confidential; and

(3) the party giving access does not authorize publication of that information.

(b) As between the parties, the information and any summaries or tabulations based on it may be used by the party given access only in a manner and for the purposes expressly authorized by the agreement or reasonably necessary for its performance.

(c) The party given assess to the information shall:

(1) act in a manner consistent with ordinary standards of the business, trade or industry of the party given access to hold the information in confidence; and

(2) on termination, make all copies of the information available to be destroyed or delivered to the other party giving access pursuant to the terms of the agreement or the reasonable instructions of that party or, in the absence of agreed terms or instructions, in a commercially reasonable manner.

(d) This section does not apply to information about a transaction, including:

(1) information collected or created to effectuate, process, or make a record of a transaction;

(2) information that describes the subject matter of a transaction; or

(3) similar transactional information.

Definitional Cross References.

"Agreement": Section 1-201. "Information": Section 2B-102. "Merchant": Section 2B-102. "Party": Section 1-201. "Reason to know": Section 2B-102. "Record": Section 2B-102. "Termination". Section 2B-102.

Notes:

1. *General Principle.* Subsection (a) states the principle that, unless agreed to the contrary, the delivering party or the person about whose business the commercial data relates maintains control of delivered data and that the recipient's right to use the data is limited to the purposes of the contract. This resolves an important issue in cases in which one party transfers data to another to enable that other party's performance of the contract. The rule applies to cases involving information that has not been released to the public and that the recipient knows is unlikely to be released. The presumption is that the information is received in a confidential manner and remains the property of the party who delivers it to the transferee.

Illustration: Staten Hospital contracts for Computer Company to provide a computer program and data processing for Staten's records on treatment and billing. Staten data are transferred electronically to Computer and processed in Computer's system. Staten remains the owner of its data. There is an obligation to return the data at the end of the contract.

2. *Remedies.* The remedies for breach of the obligations described in this section are for breach of contract. Ordinary contract remedies apply as do ordinary contract remedy limitations.

2B-310. ELECTRONIC REGULATION OF PERFORMANCE.

(a) In this section, "restraint" means a program, code, device, or similar electronic or physical limitation that restricts use of information.

(b) A party entitled to enforce a limitation on use of information which does not depend on a breach of contract by the other party may include a restraint in the information or a copy of the information and use that restraint if:

(1) a term of the agreement authorizes use of the restraint;

(2) the restraint prevents uses of the information which are inconsistent with the agreement or with informational rights which were not granted to the licensee;

(3) the restraint prevents use of the information after expiration of the stated duration of the contract or a stated number of uses; or

(4) the restraint prevents use when the contract terminates, other than on expiration of a stated duration or number of uses, and the licensor gives reasonable notice to the licensee before further use is prevented.

(c) Unless authorized by a term of the agreement, this section does not permit a restraint that affirmatively prevents or makes impracticable a licensee's access to its own information in the licensee's possession by means other than by use of the licensor's information or informational rights.

(d) A party that includes or uses a restraint pursuant to subsection (b) or (c) is not liable for any loss caused by its authorized use of the restraint.

(e) This section does not preclude electronic replacement or disabling of an earlier copy of information by the licensor in connection with delivery of a new copy or version under an agreement to electronically replace or disable the earlier copy with an upgrade or other new information.

Definitional Cross References.

"Agreement": Section 1-201. "Contract": Section 1-201. "Copy": Section 2B-102. "Delivery": Section 2B-102. "Electronic": Section 2B-102. "Information": Section 2B-102. "Informational rights": Section 2B-102. "License": Section 2B-102. "Licensee": Section 2B-102. "Licensor": Section 2B-102. "Notice": Section 1-201. "Party": Section 1-201. "Term": Section 1-201.

Official Comments:

1. *Scope of Section.* This section deals with electronic limitations on use that involve enforcement of contract terms by preventing breach. It does not involve electronic devices used to make a repossession or force discontinuation of use in the event of breach. The electronic restrictions discussed here derive from contract terms; they limit use consistent with contract terms or terminate a license at its natural end.

The basic principle is that a contract can be enforced. If the contract places time or other limits on a party's use of licensed information, electronic devices that merely enforce those limitations are appropriate. This reflects an important new capability created by digital information systems.

2**.** *Passive or Active Devices.* This Section distinguishes between active and passive electronic devices. An active device terminates the ability to make any further use of the information, while a passive device merely precludes acts that constitute a breach. Passive devices prevent unauthorized use, but leave the subject matter otherwise unaltered. Nothing in this Section authorizes active devices that impact the licensee's ability to access its own information through its own means other than the licensed information itself.

3. *Bases for Use.* Subsection (b) states alternative bases for the use of automated restraints. The section does not state exclusive rules. Federal or other law (including other sources of contract law) may also allow limiting devices. This section contains an affirmative statement of when such limiting devices are enforceable under contract law.

a. Contract Authorization. The first option arises if the contract authorizes the party to use the restrictive tool. In this respect, the authorization must be in addition to the contract term that the tool enforces.

b. Passive Restraints Preventing Breach. Subsection (b)(2) provides that for passive devices, notice is not required if the electronics merely restrict use without otherwise disabling the information. Thus, for example, assume that the contract restricts the licensee to making no more than one back-up copy and that applicable copyright law rules provide that same limitation. This subsection authorizes use of a devices to enforce that limitation, so long as the device does not destroy the licensed information. The permitted restraint enforces a contract, but does not impose a penalty for attempted breach. The limitations, for example, might entail a counter used to monitor the number of simultaneous uses or restrict use to a pre-agreed system. Although no notice is required, the agreement must support the electronic limitation. The licensee is protected by the fact that a limitation inconsistent with the licensor's rights is a breach of contract.

Illustration 1: The license provides that no more than five users may employ the word processing software at any one time. If a sixth user attempt to sign on for simultaneous use, that sixth user is electronically denied access until another user discontinues use. This limiting device is authorized without prior notice. If the limiting device disables the software if a sixth user attempts access, it is not authorized by subsection (b)(2).

c. Enforcing Property Rights. Subsection (b)(2) also allows use of passive devices that merely preclude infringing intellectual property rights. Merely preventing the act does not require contract or other notice. Thus, a contract that grants a right to make a back-up copy and to use a digital image, does not deal with the right of the licensee to transmit additional copies electronically. A device that precludes communication of the file electronically, but does not alter or erase the image in the event of an attempt to do so is authorized under (b)(2).

d. Enforcing Termination of the Contract. The restraints described in subsections (b)(3) and (b)(4) enforce termination of the license. Termination ends the license for reasons other than breach. Subsection (b)(3) corresponds to the right to terminate without notice either at the end of the fixed duration of the license, or on its termination on the happening of an agreed event. Both Article 2B and Article 2 recognize termination without notice in such cases and there is no principled reason to

distinguish between termination enforced by automated means and any other form of termination. Subsection (b)(4), on the other hand, requires notice if termination is other than for the happening of an agreed event.

Illustration 2. A license requires monthly payments of $1,000 due on the first of the month and a one year term. Licensee makes a payment five days late. Licensor uses an electronic device to turn off the software. That action is not authorized under this section since it enforces a breach of contract. Its enforceability under other law is not considered in this Article. If, however, there is no late payment, but the license reaches the end of the contractual time period and th restraint turns off the software. Termination is valid under this section.

2B-311. DELIVERY TERMS. Delivery terms such as "F.O.B." and "C.I.F." must be interpreted according to Article 2 and any applicable custom or usage of trade.

Definitional Cross Reference:

"Term". Section 1-201.

Official Comments:

This adopts the detailed treatment of shipment terms found in existing Article 2.

PART 4

WARRANTIES

2B-401. WARRANTY AND OBLIGATIONS CONCERNING QUIET ENJOYMENT AND NONINFRINGEMENT.

(a) Except in a license of a patent, a licensor of information or of informational rights which is a merchant regularly dealing in information or rights of the kind warrants that the information and informational rights shall be delivered free of the rightful claim of any third person by way of infringement or misappropriation, but a licensee that furnishes specifications to the licensor must hold the licensor harmless against any such claim that arises out of compliance with the specifications except for a claim that results from the failure of the licensor to adopt a noninfringing alternative of which the licensor had reason to know.

(b) A licensor warrants:

(1) for the duration of the contract, that no person holds a claim to or interest in the information which arose from an act or omission of the licensor, other than a claim by way of infringement or misappropriation, which will interfere with the licensee's enjoyment of its interest; and

(2) as to rights granted exclusively to the licensee, that the informational rights that are the subject of the license are valid and exclusive within the scope of the license for the information as a whole to the extent the informational rights are recognized under applicable law.

(c) The warranties in this section are subject to the following rules:

(1) If informational rights are subject to a right of public use, collective administration, or compulsory licensing, the warranty is subject to those rights.

(2) The obligations under subsections (a) and (b)(2) apply solely to informational rights arising under the laws of the United States or a State thereof unless the contract expressly provides that they extend to other countries. Language is sufficient for this purpose if it states "The licensor warrants exclusivity and noninfringement in [specified country] [worldwide]," or words of similar import. [In such case, the warranty extends to the specified country or, in the case of a reference to "worldwide" or similar language, to countries only to the extent that the rights are recognized under a treaty or international convention.]

(3) The warranties under subsections (a) and (b)(2) are not made by a financier.

(d) A warranty under this section may be disclaimed or modified only by specific language or by circumstances that give the licensee reason to know that the licensor does not warrant that competing claims do not exist or that the licensor purports to grant only the rights it may have. In an automated transaction, language is sufficient if it is conspicuous. Otherwise, language in a record is sufficient if it states "There is no warranty against interference with your enjoyment of the information or against infringement", or words of similar import.

(e) A grant of a "quitclaim", or a grant in similar terms, between merchants grants the information or informational rights without a representation or implied warranty as to infringement or as to the rights actually possessed or transferred by the grantor.

Uniform Law Source: Section 2A-211; Section 2-312. Revised.

Definitional Cross References.

"Automated transaction": Section 2B-102. "Conspicuous": Section 2B-102. "Contract": Section 1-201. "Information": Section 2B-102. "Informational rights": Section 2B-102. "License": Section 2B-102. "Licensee": Section 2B-102. "Licensor": Section 2B-102. "Merchant": Section 2B-102. "Person": Section 1-201. "Reason to know": Section 2B-102. "Record": Section 2B-102. "Rights": Section 1-201. "Scope": Section 2B-102. "Term": Section 1-201.

Official Comments:

1. *Non-Infringement Warranty.* Subsection (a) contains the affirmative warranty of non-infringement applicable to persons who are merchants in information of the particular kind. The language comes from Article 2 and requires the information to be delivered free of any claim of infringement or the like. This means (1) that, if the information were used and the licensed rights exercised in all of the ways granted by the licensor at the time of delivery, the use would not be subject to a claim of infringement and (2) that the delivery itself does not infringe a third party property right which would subject the licensee to liability for receiving that delivery. If no infringement claim exists on this basis, but, for example, a contract grants a three year license when the transferor's rights are limited to two years, the cause of action is for breach of contract, not breach of the infringement warranty. Liability under this warranty is based on conditions at the time the copy is delivered.

The warranty does not apply to the licensor of a patent. This refers to a party licensing a patent per se. Thus, if a party licenses software and the software is supported in part by patent rights, the warranty is breached if use of the software infringes a third party patent. On the other hand, if a licensor grants a license for the patent itself, that license does not create a warranty under subsection (a). A patent does not create an affirmative right to use technology, but merely a right to prevent another person's use. Reflecting this, patent licenses are mere waivers of the right to sue and do not promise a right to non-infringing use of the patented technology unless the contract expressly so provides.

> **Illustration:** Consider a license of clip art under which the licensor conveys a right to make derivative works from the clip art and to publicly perform or display the art. The warranty is that the licensor was authorized by the copyright owner to make the copy and distribute it. It also requires that the license of derivative work and public display rights give the licensee an actual right to use without infringing on the date of delivery. That latter warranty is tested by whether, at the time of delivery, if the licensee had made a derivative work and a public display, these would infringe. They might do so, for example, if the licensor had not itself been authorized to license these rights by the copyright owner.

Since subsection (a) uses language from existing Article 2, the comments to existing Section 2-312 are relevant. The warranty is made only by a person that is a merchant in information of this kind. The "hold harmless" obligation only applies if the infringement arises from compliance with licensee specifications, not because of choices of the licensor in implementing general specifications or goals of the licensee.

2. *Non-Infringement and Passive Transmission.* The obligation in subsection (a) applies only to licensors of information. It does not apply to persons who provide communications or transmission services. In copyright law, the issue of under what circumstances a transmittal entity has liability for infringement is controversial. Article 2B has no effect on federal questions about what constitutes infringement. This section follows a contract law premise that commitments about the absence of infringing material **between two parties to a contract** are appropriate. Whether, a particular party is a "licensor of information" for contract law depends on the circumstances of the contract. It has no bearing on whether a passive transmission provider is liable for infringement to the **owner of the intellectual property rights**.

3. *Quiet Enjoyment Warranty.* Subsection (b)(1) deals with issues other than infringement. The licensor warrants that it will not interfere with the licensee's exercise of rights under the contract. Non-interference is the essence of the contract. This "quiet enjoyment" warranty reflects the licensor's implied commitment to not act in a manner that detracts from the rights granted to the licensee for the term of the license by interfering with the licensee's use.

4. *Exclusivity Warranty.* Subsection (b)(2) deals with obligations arising when the transaction is an exclusive license. "Exclusivity" pertains to two issues not relevant in non-exclusive licenses. The first involves the validity of the intellectual property rights. Validity corresponds to whether the information is in the public domain. The converse of validity is that the information under property law can be used or recreated by anyone. It is important if a licensee relies on the rights transferred to create a product for third parties. An exclusive licensor warrants that the rights conveyed are valid.

The second issue involves whether a **portion** of the rights may be vested in another person because co-authors or co-inventors were involved. Alternatively, the transferor may have executed a prior license to a third party. In an exclusive license, the licensor warrants that this is not true. For non-

exclusive licenses, the question of whether intellectual property rights are **exclusive** in the licensor is insignificant because it does not alter the end user's ability to continue to use the licensed rights without challenge.

Exclusivity and validity are warranted only to the extent recognized in law. Thus, the licensor of a trade secret warrants that it has not granted rights to another person, but cannot be held to warrant that no other person independently holds or may discover the secret information. A trade secret gives no rights against independent discovery and, thus, the warranty does not purport to claim that no one else knows or uses the secret information.

5. *International Issues.* Intellectual property rights are territorial in character in that they extend only within the territory of the state that creates them, except as some deference internationally occurs through multi-lateral treaties. Subsection (c)(2) parallels this facet of intellectual property law and provides that the obligations created about exclusivity and infringement extend only within this country and to a country specifically referenced in the license.

6. *Disclaimer.* Article 2B provides for disclaimer of the warranties under this Section based on language from existing Article 2. This requires specific language or circumstances indicating that the warranties are not given. In addition, consistent with the general approach of contract law as a planning tool, illustrative language is provided for purposes of disclaimer.

2B-402. EXPRESS WARRANTIES.

(a) Subject to subsection (c), express warranties by a licensor are created as follows:

(1) An affirmation of fact or promise made by the licensor to its licensee in any manner, including in a medium for communication to the public such as advertising, which relates to the information and becomes part of the basis of the bargain creates an express warranty that the information required to be furnished under the agreement shall conform to the affirmation or promise.

(2) A description of the information which is made part of the basis of the bargain creates an express warranty that the information shall conform to the description.

(3) A sample, model, or demonstration of a final product which is made part of the basis of the bargain creates an express warranty that the performance of the information will reasonably conform to the performance illustrated by the sample, model, or demonstration, taking into account such differences as would appear to a reasonable person in the position of the licensee between the sample, model, or demonstration and the information as it will be used.

(b) It is not necessary to the creation of an express warranty that the licensor use formal words such as "warrant" or "guarantee", or state a specific intention to make a warranty. However, an affirmation or prediction merely of the value of the information, a display or description of a portion of the information to illustrate the aesthetics, market appeal or the like, of informational content, or a statement purporting to be merely the licensor's opinion or commendation of the information does not create a warranty.

(c) [This article does not alter the standards under which an express warranty or an express contractual obligation for published informational content is created or not created. If an express warranty or contractual obligation is created for published informational content and is breached, the remedies of the aggrieved party are pursuant to this article and the agreement.]

At the nccusl annual meeting, a motion to delete subsection (c) was defeated overwhelmingly. in its deliberations, the committee of the whole had before it the bracketed proposal from the chair of the committee and the reporter and favorable comments were received about the proposal as a clarification of the prior language of the subsection.

Uniform Law Source: Section 2A-210. Section 2-313.

Definitional Cross References.

"Aggrieved party": Section 1-201. "Agreement": Section 2B-102. "Information": Section 2B-102. "Informational content": Section 2B-102. "Licensee": Section 2B-102. "Licensor": Section 2B-102. "Party": Section 1-201. "Published informational content": Section 2B-102. "Remedy": Section 1-201. "Value": Section 1-201.

Official Comments:

1. *Basis of the Bargain: General Approach.* This section adopts existing Article 2, except with respect to published informational content, where it preserves current law relating to express obligations.

Subsection (a) retains the "basis of the bargain" standard. This allows courts and parties to draw on an extensive body of case law for distinguishing express warranties from puffing and other, non-enforceable statements. While the cases involve difficult factual determinations, they provide better guidance than would an entirely new standard.

While there has been some dispute about the meaning of the traditional "basis of the bargain" standard, the concept is that express affirmations, promises and the like are enforceable as express warranties if they fit within the matrix of elements that constitute the bargain of the parties, but that they are not enforceable as express warranties if they are not part of the basis of the contractual deal. This standard does not require proof of reliance on a particular representation to make the deal, but enables a more general showing that the statements are part of the deal and basic to it.

2. *Basis of the Bargain: Advertising.* Subsection (a)(1) conforms to existing Article 2, except that it expressly provides that advertising may create an express warranty. This expands the scope of express warranty law in some states. Statements made in advertising, of course, are often mere puffing which does not create a warranty. As with other statements, a warranty arises only if the statement becomes part of the bargain and a bargain actually occurs. In the absence of such a relationship, liability for false advertising, if any, would not be under contract law, but under tort or advertising law rules.

3. *Basis of the Bargain: Samples and Models.* Subsection (a)(3) expands current Article 2 by expressly referring to express warranties created by demonstrations of an information product.

Representations created by demonstrations and models must be gauged by what inferences would be communicated to a reasonable person in light of the nature of the demonstration, model, or sample. In the world of goods, showing a sample of a keg of raw beans by lifting out a cup-full communications one inference as to a whole, while a demonstration of a complex database program running ten files creates an entirely different inference if the intended use of the system is to process ten million files. The standard follows the approach of most courts to such issues.

4. *Published Informational Content.* Subsection (c) preserves current law for published informational content. While there are many reported cases dealing with express warranties in goods and using the standards adopted here, no case law exists for published informational content using the Article 2 standards. This subject matter entails significant First Amendment interests and general public policies that favor encouraging public dissemination of information. Courts that deal with liability risks pertaining to this subject matter must balance contract themes with more general social policies.

The intent is to leave undisturbed existing law dealing how obligations are established with reference to published information. Courts, if inclined to find contract liability for published information, may do so under general contract law theory. Many will conclude that the broad risk in the published content situation and the potentially stifling effect that imposing contract liability in that realm might have on the dissemination of speech should lean toward limiting or excluding liability in that context. However, merely adopting Article 2 concepts from sales of goods to this much different context would risk a large and largely unknown change or over-reaching of liability in a sensitive area.

2B-403. IMPLIED WARRANTY: MERCHANTABILITY OF COMPUTER PROGRAM.

(a) Unless disclaimed or modified, a warranty that a delivered computer program and any physical medium on which it is delivered are merchantable is implied if the licensor is a merchant with respect to computer programs of that kind.

(b) To be merchantable, a computer program and any physical medium on which it is delivered must:

(1) pass without objection in the trade under the contract description;

(2) be fit for the ordinary purposes for which it is distributed;

(3) in the case of multiple copies, consist of copies that are, within the variations permitted by the agreement, of even kind, quality, and quantity, within each unit and among all units involved;

(4) be adequately contained, packaged, and labeled as the agreement may require; and

(5) conform to the promises or affirmations of fact made on the container or label, if any.

(c) Unless disclaimed or modified, other implied warranties may arise from course of dealing or usage of trade.

(d) A warranty created under this section applies to the functionality of a computer program but does not relate to informational content, including its aesthetics, market appeal, accuracy, or subjective quality, whether or not the content is included in or created by a computer program.

Uniform Law Source: Section 2-314; 2A-212. Revised.

Definitional Cross References.

"Agreement": Section 1-201. "Computer program": Section 2B-102. "Contract": Section 1-201. "Delivery": Section 2B-102. "Informational content": Section 2B-102. "Licensor". Section 2B-102. "Merchant". Section 2B-102.

Notes:

1. *Background and Policy.* Article 2B warranties blend three different legal traditions. **One** stems from Article 2 and focuses on the quality of the product. This centers on the **result** delivered: a product that conforms to ordinary standards for products of that type. The **second** stems from common law, including cases on licenses, services contracts and information contracts. This tradition focuses on how a contract is performed, the **process** rather than the result. The transferor's obligations are to perform in a reasonably careful and workmanlike manner. The **third** comes from contracts for informational content. It disallows implied warranties and implied obligations of accuracy in information transferred other than in a special relationship of reliance.

Current case law selects the applicable rule in part based on a court's characterizations about whether a transaction involves **goods** or not. That distinction is not reliable and is unworkable in Article 2B. In this and the following Section, Article 2B distinctions are drawn between computer programs, on the one hand, to which an implied warranty of result is applied, and information or services, on the other hand, to which a process warranty applies. The policy is that warranties focused on result and merchantability are appropriate for information that most closely resembles functional products - computer programs.

2. *Expanded Application.* This Section applies the Article 2 warranty of merchantability to computer programs. Since this Section applies to all computer programs provided by a merchant, it expands the scope of the merchantability warranty by including cases that under current law are treated as a services contract with no warranties or with warranties limited to making a reasonable effort. The warranty does not apply if the contract is for processing, analysis or other services and the licensor merely uses a computer program in its own activities. It applies if the program itself is the subject matter of the agreement.

3. *Dual Application.* The implied warranty in this Section and the warranty in Section 2B-404 may both apply to the same transaction and the same information product (e.g., an encyclopedia). The one would apply to the program and its functions, while the other would apply to the accuracy of data provided to the end user.

Illustration 1: Party A contracts to license software to Party B to process B's accounts receivable. Whether the transfer is by diskette or by electronic conveyance, the merchantability warranty applies.

Illustration 2: Party A licenses B to use a copy of the Marvel Encyclopedia. This Section applies to the computer program and diskette, while Section 2B-404 applies to the content of the encyclopedia.

4. *Merchantability.* The merchantability warranty generally corresponds to original Article 2, except where the difference between software and goods requires a difference in the formulation of the definition. Since most modern agreements disclaim the warranty of merchantability, there are few reported commercial cases involving merchantability in any industry, including the software industry. Merchantability standards ask what are normal characteristics of ordinary products of the type.

2B-404. IMPLIED WARRANTY: INFORMATIONAL CONTENT.

(a) Unless disclaimed or modified and subject to subsection (b), a merchant that in a special relationship of reliance provides informational content or services to collect, compile, process, or transmit informational content warrants to its licensee that there is no inaccuracy in the informational content caused by its failure to exercise reasonable care in its performance.

(b) A warranty does not arise under subsection (a) with respect to:

(1) the aesthetics, market appeal, or subjective quality of the informational content;

(2) published informational content; or

(3) a person that acts as a conduit or provides only editorial services in collecting, compiling, or distributing informational content identified as having been prepared or created by a third party.

Uniform Law Source: Restatement (Second) of Torts 552.

Definitional Cross References.

"Informational content". Section 2B-102. "Licensee". Section 2B-102. "Merchant". Section 2B-102. "Party". Section 1-201. "Published informational content". Section 2B-102.

Official Comments:

1. *Scope and Effect.* This section creates a new implied warranty for consulting, data processing, and informational content contracts. The warranty focuses on the accuracy of data and reports, but incorporates a concept from common law.

The standard adopted is consistent with the process-oriented rules that the common law courts that find any obligation typically apply in similar contexts. See, e.g., **Restatement (Second) of Torts** 552 ("One who ... supplies false information for the guidance of others in their business transactions, is subject to liability for pecuniary loss caused to them by their justifiable reliance on the information, if he fails to exercise reasonable care or competence in obtaining or communicating the information."). The appropriate approach here is not an absolute liability standard for accuracy, but a protected assurance that no errors are caused by a failure of reasonable care.

2. *Terms and Existence of the Warranty.*

a. Accuracy and Care. Subsection (a) gives a warranty that no inaccuracy exists due to the provider's lack of reasonable care. This does not make warranty assurances about aesthetics or marketability. These are subjective issues. Assurances on these issues require express contract terms.

Accuracy relates to what the information purports to be. A license of a large mailing list of addresses does not create an implied warranty of 100% accuracy. A contract to estimate the number of end users in Houston does not imply an accurate estimate, but merely an estimate. The warranty adopts the rulings of cases such as **Lockwood v. Standard & Poor's Corp.,** No. 1-95-3063, 1997 WL 323659 (Ill. App. June 13, 1997).

Inaccuracy does not, in itself, establish breach of warranty. An actionable inaccuracy is one caused by a lack of reasonable care.

b. Merchants. The warranty applies only to merchants in the particular type of information. When dealing with a merchant, the licensee has a rightful expectation that errors are not created by lack of care.

c. Special Relationship of Reliance. The warranty arises only if the information is provided in a special relationship of reliance. This language follows cases applying the **Restatement** standard. The warranty-creating transaction involves more than merely making information generally available. It does not require a fiduciary relationship, but does require indicia of special reliance. The case law under the **Restatement** provides applicable guidance. See **A.T. Kearney v. IBM**, -- F.3d - (9th Cir. 1997); **Daniel v. Dow Jones & Co., Inc.,** 520 N.Y.S.2d 334 (NY City Ct. 1987).

This excludes information distributed to the public. That is made explicit in subsection (b)(2). This exclusion stems from First Amendment and general social norms about the value of encouraging distribution of information.

Illustration: Sam's website provides information on restaurants for a small monthly fee. The website contains published informational content and no implied warranty. The same is true of a restaurant review in the New York Times under non-Article 2B law.

Information systems analogous to newspapers, magazines, or books and are treated as such here for purposes of contract law. "Technology is rapidly transforming the information industry. A computerized database is the functional equivalent of a more traditional news vendor, and the inconsistent application of a lower standard [enabling] liability [for] an electronic news distributor ... than that which is applied to a public library, book store, or newsstand would impose and undue burden on the free flow of information." **Cubby, Inc. v. CompuServ, Inc.,** 3 CCH Computer Cases 46,547 (S.D.N.Y. 1991); **Daniel v. Dow Jones & Co., Inc.,** 520 N.Y.S.2d 334 (NY City Ct. 1987).

3. *Exclusions.* Subsection (b) lists various exclusions from the warranty.

a. Aesthetics and Published Content. Subsection (b)(1) clarifies that this is not a warranty of aesthetic quality, but accuracy. Subsection (b)(2) exempts published informational content. Both points, although they could be inferred from the terms of the warranty itself and were added for clarity.

b. Conduits. Subsection (b)(3) holds a publisher harmless from claims based on inaccuracies in third party materials merely distributed by it. Merely providing a conduit for third party data should not create an obligation to ensure the care exercised in reference to the data provided by the third party. On the related issue of tort liability, see **Winter v. G.P. Putnam's Sons**, 938 F.2d 1033 (9th Cir. 1991).

2B-405. IMPLIED WARRANTY: LICENSEE'S PURPOSE; SYSTEM INTEGRATION.

(a) Unless disclaimed or modified, and except as otherwise provided in subsection (b), if a licensor at the time of contracting has reason to know any particular purpose for which the information is required and that the particular licensee is relying on the licensor's skill or judgment to select, develop, or furnish suitable information, there is an implied warranty that the information shall be fit for that purpose.

(b) Unless disclaimed or modified, if from all the circumstances, it appears that a licensor was to be paid for the amount of its time or effort regardless of the fitness of the information, the implied warranty is that the information will not fail to achieve the licensee's particular purpose as a result of the licensor's lack of reasonable care.

(c) There is no warranty under subsections (a) and (b) with regard to:

(1) the aesthetics, market appeal, or subjective quality of informational content; or

(2) published informational content, but there may be a warranty with regard to the licensor's selection among different existing copies of published informational content from different publishers.

(d) If an agreement requires a licensor to provide or select a system consisting of computer programs, and goods, and the licensor has reason to know that the licensee is relying on the skill or judgment of the licensor to select the components of the system, there is an implied warranty that the components provided or selected will function together as a system.

Uniform Law Source: Section 2-315; 2A-213. Substantially revised.

Definitional Cross References.

"Agreement": Section 1-201. "Computer program": Section 2B-102. "Information": Section 2B-102. "Informational content": Section 2B-102. "Licensee": Section 2B-102. "Licensor": Section 2B-102. "Published informational content": Section 2B-102. "Reason to know": Section 2B-102

Official Comments:

1. *General Approach.* This Section reconciles diverse case law and also creates, in subsection (d), a new implied warranty. It clarifies the standard under which a licensee receives an implied assurances of a particular result, expanding the circumstances in development and design contracts under which this assurance occurs.

Subsection (a) states as a general rule that in some cases reliance creates an implied warranty of a result fit for the licensee's purpose. Subsection (b) applies the common law "efforts" standard in other cases. This bifurcation deals with the issue of whether the appropriate implied obligation is an obligation to produce a result (present in sales of goods) or an obligation to make an effort to achieve a result (common law). Under prior case law in software and other fields, the decision is based on whether a court views the transaction as a sale of goods (result) or a contract for services (effort). The reported decisions are split and often lack a principled basis for distinction.

Of course, express contract terms control over either variation of the implied warranty.

2. *Warranty of Fitness.* Subsection (a)(1) adopts the rule of existing Article 2-305.

This obligates the provider to meet known licensee needs if the circumstances indicate that the licensee is relying on the provider's expertise to achieve this result. There are many development contract and other situations where no such reliance exists, including cases where the licensee provides the contract performance standards, rather than relying on the provider to fill an acknowledged need of the licensee. Then there is no reliance on the licensor about whether meeting the specifications will meet applicable needs.

3. *Services and Warranty.* This section does not override the general law of services contracts. Under that law, the services provider in a skilled context does not guaranty suitability unless it expressly agrees to do so. Subsection (a)(2) proposes one standard to determine when a contract calls for services, rather than a result. Other standards evolved under general common law may also indicate that the parties intended a services obligation as delineated in subsection (a)(2).

4. *System Integration.* Subsection (d) creates a new implied warranty that requires systems performance in cases of systems integration contracts. While related to the implied fitness warranty, it expands that concept creating new protection for licensees. The warranty is that the selected components will function as a system. This does not mean that the system, other than as stated in subsection (a) and (b), will meet the licensee's needs. Neither does it mean that use of the system does not or may not infringe third party rights. This warranty refers to an assurance that the parts will functionally operate as a system. This is an additional assurance beyond the fact that each component must be separately functional.

2B-406. DISCLAIMER OR MODIFICATION OF WARRANTY.

(a) Words or conduct relevant to the creation of an express warranty and words or conduct tending to disclaim or modify an express warranty must be construed wherever reasonable as consistent with each other. Subject to Section 2B-301 with regard to parol or extrinsic evidence, disclaimer or modification is inoperative to the extent that this construction is unreasonable.

(b) Except as otherwise provided in subsections (c), (d), and (e), to disclaim or modify an implied warranty or any part of it, but not the warranty in Section 2B-401, the following rules apply:

(1) The disclaimer or modification must be in a record.

(2) To disclaim or modify an implied warranty arising under Section 2B-403 or 2B-404 language that mentions "merchantability" is sufficient as to Section 2B-403, and language that mentions "accuracy", or words of similar import, is sufficient as to Section 2B-404.

(3) To disclaim or modify an implied warranty arising under Section 2B-405, it is sufficient to state "There is no warranty that this information or my efforts will fulfill any of your particular purposes or needs", or words of similar import.

(4) Language is sufficient to disclaim all implied warranties if it individually disclaims each implied warranty or states "Except for express warranties stated in this contract, if any, this [information] [computer program] is being provided with all faults, and the entire risk as to satisfactory quality, performance, accuracy, and effort is with the user", or words of similar import.

(5) Language sufficient to disclaim or modify an implied warranty of merchantability under Article 2 or 2A is sufficient to disclaim or modify the warranties under Sections 2B-403 and 2B-404, and language sufficient to disclaim or modify an implied warranty of fitness for a particular purpose under Article 2 or 2A is sufficient to disclaim or modify the warranties under Section 2B-405.

(6) In a mass-market transaction, language that disclaims or modifies an implied warranty must be conspicuous.

(c) Unless the circumstances indicate otherwise, all implied warranties, but not the warranty in Section 2B-401, are disclaimed by expressions like "as is" or "with all faults" or other language that in common understanding call the licensee's attention to the disclaimer of warranties and makes plain that there are no implied warranties.

(d) There is no implied warranty under Sections 2B-403, 2B-404, or 2B-405 with respect to a defect that before entering the contract was known to, discovered by, or disclosed to the licensee, or that would have been discovered by the licensee if it had made use of a reasonable opportunity provided to it before entering into the contract to examine, inspect, or test the information or a sample thereof, unless the licensee was not aware of the defect after examination and the licensor knew that it existed at that time.

(e) An implied warranty can also be disclaimed or modified by course of performance, course of dealing, or usage of trade.

(f) If a contract requires ongoing performance or a series of performances by the licensor, language of disclaimer or modification which complies with this section is effective with respect to all performances under the contract.

(g) Remedies for breach of warranty may be limited in accordance with this article.

Uniform Law Source: Section 2A-214. Revised.

Definitional Cross References.

"Computer program": Section 2B-102. "Conspicuous": Section 2B-102. "Contract": Section 1-201. "Information": Section 2B-102. "Licensee": Section 2B-102. "Licensor": Section 2B-102. "Mass-market license": Section 2B-102. "Record": Section 2B-102.

Official Comments:

1. *General Structure and Policy.* This Section brings together various rules relating to the disclaimer of warranties. As in current Article 2, rules on disclaimer of the warranties relating to infringement are contained in another section (Section 2B-401).

The general approach corresponds to existing Article 2 and Article 2A. U.S. law recognizes that parties may disclaim or limit implied warranties. Implied warranties are default, rather than mandatory rules. Disclaimer and limitation is integral to the contract choice paradigm under which commerce occurs and to the ability of a party to choose the terms under which it markets information and the risk it elects to undertake.

This Article does not alter consumer protection law. See Section 2B-105.

2. *Express Warranties.* Subsection (a) restates current Article 2 law. It uses modern language of "disclaimer" and "modification", rather than current Article 2 language, without substantive change.

3. *Disclaimer of Implied Warranties: General Rules.* Subsection (b) brings together various provisions on disclaimer of implied warranties.

a. Record Required. Article 2B changes existing law and, except for cases noted in subsection (c), (d) and (e), requires that a disclaimer be in a record. This increases the likelihood that the disclaimer will be brought to the other party's attention and provides a statute of frauds requirement against fraudulent claims that a disclaimer occurred.

b. Conspicuousness. Except for mass-market licenses, Article 2B does not require that a disclaimer be conspicuous. Outside the mass market, this requirement provides a trap for persons drafting contracts who are found later to have failed to meet applicable standards that the language be conspicuous. Current Article 2 requires a conspicuous disclaimer only if the disclaimer is in writing.

c. Merchantability and Accuracy Warranties. Subsection (b)(2) follows current law and provides language that suffices to disclaim the merchantability, quality and accuracy warranties.

As in existing Article 2, the language is not mandatory. Other language also works if it reasonably achieves the purpose of indicating that the pertinent warranty is are not given in the particular case.

d. Fitness Warranty. Subsection (b)(3) follows current law and provides language adequate to disclaim the warranty under Section 2B-405. The language here is more explicit than under Article 2. As in Article 2, the language is not mandatory. This language works, but other language may also work if it reasonably achieves the purpose; that purpose is to indicate that the pertinent warranty is not given in the particular case.

e. Article 2 and 2A Disclaimers. Subsection (b)(5) provides for cross-article validity of disclaimer language. The intent is to avoid traps for parties from having to make a priori determinations about the extent of Article 2B or Article 2 coverage. In effect, language adequate to disclaim a warranty under the one article is adequate to disclaim the equivalent warranty under the other.

4. *Mass-Market Disclaimers.* Subsection (b)(4) provides that a disclaimer in a mass market environment must be conspicuous and in a record except as provided in subsections (c), (d), and (e).

5. *"As is" and General Disclaimers.* Subsection (c)(1) follows existing Article 2 language, providing parties with a means of conducting business without giving assurances of quality. The "as is" language need not be in a record. It is not effective with respect to the infringement warranty unless the circumstances or language satisfy the standard stated in Section 2B-401.

Subsection (c)(2) deals with where the intent is to disclaim all warranties in a single sentence. The subsection sets out a common language disclaimer as a means of giving more disclosure to the consumer of what is disclaimed. As in Article 2, the specified language is not mandatory. This language works, but other language also works if it reasonably achieves the purpose of indicating that the warranties are not given in the particular case.

6. *Excluding Warranties by Inspection or General Circumstances.* Subsection (d) and (e) are taken from Article 2 with modifications.

a. Inspection and Disclosure. As in Article 2, an information provider is not responsible for defects that were either 1) known by or disclosed to the other party, or 2) could have been discovered on reasonable inspection if the opportunity to inspect was available.

b. Course of Dealing, etc. Subsection (e) is from existing Article 2.

2B-407. MODIFICATION OF COMPUTER PROGRAM. A licensee that modifies a copy of a computer program, other than by using a capability of the program intended for that purpose in the ordinary course, invalidates any warranties, express or implied, regarding performance of the modified copy, but not an unmodified copy. A modification occurs if a licensee alters code in, deletes code from, or adds code to. the computer program.

Definitional Cross References.

"Computer program". Section 2B-102. "Copy". Section 2B-102. "Licensee". Section 2B-102.

Official Comments:

1. *Scope.* This method of losing warranty protection applies only to warranties related to the performance of software. It does not apply to title and non-infringement warranties. It applies only to the modified copy. If the defect existed in an unmodified copy, the modifications have no effect.

The basis for the provision lies in the fact that because of the complexity of software systems changes may cause unanticipated and uncertain results. The complexity of software means that it will often not be possible to prove to what extent a change in one aspect of a program altered its performance as to other aspects.

2. *Application.* The section voids the warranties unless the contract, or an agreement, indicates that modification does not alter performance warranties. The section covers cases where the licensee makes changes that are not part of the program options. Thus, if a user employs the built-in capacity of

a word processing program to tailor a menu of options suited to the end user's use, this section does not apply. If, on the other hand, the end user modifies code in a way not made available in the program options, that modification voids all performance warranties as to the altered copy.

2B-408. CUMULATION AND CONFLICT OF WARRANTIES.

Warranties whether express or implied shall be construed as consistent with each other and as cumulative, but if this construction is unreasonable, the intention of the parties determines which warranty is dominant. In ascertaining that intention, the following rules apply:

(1) Exact or technical specifications displace an inconsistent sample or model or general language of description.

(2) A sample displaces inconsistent general language of description.

(3) Express warranties displace inconsistent implied warranties other than an implied warranty under Section 2B-405(a).

Uniform Law Source: § 2-317.

Definitional Cross Reference.

"Party". Section 1-102.

Official Comments: This Section follows existing Article 2.

2B-409. THIRD-PARTY BENEFICIARIES OF WARRANTY.

(a) Except for published informational content, a warranty to a licensee extends to persons for the benefit of which the licensor intends to supply the information and which rightfully use the information in a transaction or application of a kind in which the licensor intends the information to be used.

(b) A warranty to a licensee extends to each individual consumer in the immediate family or household of the licensee if it was reasonable to expect that individual would rightfully use the information.

(c) A term of the agreement that excludes or limits third-party beneficiaries excludes or limits any contractual obligation or liability to third persons other than individuals described in subsection (b).

(d) A disclaimer or modification of a warranty or remedies which is effective against the licensee is effective against any third person under this section.

Definitional Cross References.

"Consumer transaction". Section 2B-102. "Information". Section 2B-102. "Licensee". Section 2B-102. "Licensor". Section 2B-102. "Party". Section 1-201. "Person". Section 1-201. "Published informational content". Section 2B-102. "Remedy": Section 1-201. "Rights": Section 1-201. "Term": Section 1-201.

Official Comments:

1. *Focus and Policy.* This section defines third-party beneficiary concepts. It adopts an approach based on the contract law theory of "intended beneficiary" and on the *Restatement (Second) of Torts* § 552 dealing with the scope of liability to third parties for a provider of information. It expands both concepts as applied to household uses.

The California Supreme Court in **Bily v. Arthur Young & Co.**, 3 Cal. 4th 370, 11 Cal. Rptr. 2d 51, 834 P2d 745 (1992), commented:

> By confining what might otherwise be unlimited liability to those persons whom the engagement is designed to benefit, the Restatement rule requires that the supplier of information have notice of potential third party claims, thereby allowing it to ascertain the potential scope of its liability and make rational decisions regarding the undertaking.

To impose liability under contract-related theories, the information provider must have known of and clearly intended to have an effect on the third parties. This requires a conscious assumption of risk or responsibility for particular third parties. Even within that standard, courts should not be aggressive in finding the requisite intent.

All of this relates to the unique role of information in our culture and to the uniquely difficult nature of proving a causal connection between a release of information and harmful effects. The cases and this section also reflect sensitivity to the risk that placing excessive liability exposure on information providers without their expressly undertaking may chill the willingness of those providers to disseminate information.

2. *Product Liability Law.* This Section does not deal with products liability issues. It neither expands nor restricts tort concepts that might apply for third party risk. Products liability is governed by tort law. Article 2B leaves development of any appropriate liability doctrine to common law courts. As a matter of

fact, few courts impose third party liability in information. The *Restatement (Third) on Products Liability* recognizes this; it notes that informational content is **not** a product for purposes of that law. The only reported cases that impose product liability on information involve air flight charts. The cases analogized the technical charts to a compass or similar, physical instrument. These cases have not been followed in any other context.

Most courts specifically decline to treat information content as a product, including the Ninth Circuit, which decided two of the air flight chart cases, but later commented that public policy accepts the idea that information once placed in public moves freely and that the originator does not owe obligations to those remote parties who obtain it. See **Winter v. G. P. Putnam's Sons,** 938 F.2d 1033 (9th Cir. 1991); **Fairbanks, Morse & Co. v. Consolidated Fisheries Co.,** 190 F.2d 817, 824 (3rd Cir. 1951); **Berkert v. Petrol Plus of Naugatuck**, 216 Conn. 65, 579 A.2d 26 (Conn. 1990); **Porter v. LSB Industries, Inc.**, 1993 WL 264153 (N.Y.A.D. 4 Dept. 1993); **E.H. Harmon v. National Automotive Parts**, 720 F. Supp. 79 (N. D. Miss. 1989); **Snyder v. ISC Alloys, Ltd**, 772 F Supp. 244 (W. D. Pa. 1991); **Jones v. Clark**, 36 N. C. App. 327, 244 S.E.2d 183 (N. C. App. 1978).

3. *Embedded Software.* While there may be a different policy for software embedded in tangible products, this Article does not deal with embedded software. See Section 2B-104. Tort law and contract privity issues regarding, for example, the software that operates the brakes in an automobile fall within Article 2.

4. *Intended Effect Required.* Subsection (a) derives from and should be interpreted in light of both the contract law concept of "intended beneficiary" and the concept in the Restatement (Second) of Torts § 552. In both instances, contract-based liability is restricted to intended third parties and those in a special relationship with the information provider. The liability extends to transactions that the provider of information intended to influence. This Section incorporates these concepts. The section also must be considered in light of the scope of warranties under this Article which create no implied warranty of accuracy pertaining to published informational content.

> **Illustration:** Clanc contracts for publication of his text on chemical interactions. Publisher obtains an express warranty that Clanc exercised reasonable care in researching. Publisher distributes the text to the general public. Some data are incorrect. Neither Publisher (which makes no warranty for published information), nor Clanc (excluded under (a) makes a warranty to a general buyer of the book.

5. *Family Effects.* Subsection (b) modifies beneficiary concepts to include the family of a licensee. This goes beyond the relevant alternative in current Article 2-318 which limits that extension to personal injury claims. This covers both personal injury and economic losses.

6. *Limitation by Contract.* The policy adopted here focuses on the information provider's original intent with respect to third parties. Subsections (c) and (d) flow from the fact that the basis of this section lies in beneficiary status, rather than product liability. A disclaimer or a statement excluding intent to effect third parties excludes liability under this section. This follows current law. See, e.g., **Rosenstein v. Standard and Poor's Corp.**, 1993 WL 176532 (Ill. App. May 26, 1993).

PART 5

TRANSFER OF INTERESTS AND RIGHTS

The relevant provisions of this part will coordinated to be consistent with the provisions of Article 9 relating to creation and perfection of a security interest.

2B-501. OWNERSHIP OF RIGHTS AND TITLE TO COPIES.

(a) If a contract provides for transfer of ownership of informational rights in computer software, ownership passes:

(1) at the time and place specified by contract; or

(2) in the absence of such specification:

(A) when the contract becomes enforceable, if the informational rights are then in existence and identified to the contract; or

(B) when the information and the informational rights are identified to the contract, if the information is not in existence or identified to the contract when the contract becomes enforceable.

(b) The following rules apply to copies:

(1) Transfer of a copy does not transfer ownership of informational rights in the information.

(2) In a license:

(A) title to a copy is determined by the license;

(B) a licensee's right to possession or control of a copy is governed by the license and does not depend on title to the copy; and

(C) if a licensor reserves title to a copy, the licensor also has title to any copies made of it, unless the license grants the licensee a right to make and transfer copies to others, in which case reservation of title reserves title only to copies delivered to the licensee by the licensor.

(c) If the contract provides for transfer of title to a copy, title passes:

(1) at the time and place specified in the contract; or

(2) in the absence of such specification

(A) in a transaction involving delivery of a copy on a physical medium, at the time and place at which the licensor completed its obligations with respect to delivery of that copy.

(B) in a transaction involving an electronic delivery of a copy, if a first sale occurs under federal copyright law, at the time and place at which the licensor completed its obligations with respect to delivery of the copy.

(d) If the party to which ownership or title passes under the contract refuses delivery of the copy or refuses the terms of the contract, ownership and title revest in the licensor.

Uniform Law Source: Section 2-401; section 2A-302. Revised.

Definitional Cross References.

"Agreement": Section 1-201. "Contract": Section 1-201. "Copy": Section 2B-102. "Delivery": Section 2B-102. "Electronic": Section 2B-102. "Identified": Section 2-501. "Information": Section 2B-102. "Informational rights": Section 2B-102. "License": Section 2B-102. "Licensee": Section 2B-102. "Licensor": Section 2B-102. "Party": Section 2B-102. "Rights": Section 1-201. "Sale": Section 2B-102. "Transfer". Section 2B-102.

Official Comments:

1. *Copy vs. Rights Ownership.* This section distinguishes title to the copy from ownership of the intellectual property rights. The distinction flows from the Copyright Act and other law. It means that, while ownership of a copy may give some rights with respect to that copy, it does not convey ownership of the underlying property rights to the work of authorship or patented invention. The media is not the message, but merely the conduit.

2. *Timing of Rights Ownership Transfer.* Subsection (a) deals with intellectual property rights and when ownership of the rights transfers as a matter of state law. This deals with cases where there is an intent to transfer title to intellectual property rights (as compared to title to a copy). If federal law requires a writing to make this ownership transfer; state law is subject to that rule.

The subsection solves the problem in **In re Amica**, 135 Bankr. 534 (Bankr. N.D. Ill. 1992). Transfer of rights ownership does not hinge on delivery of a copy. Rather, it refers to identification to the contract, including both completion to a sufficient level that separates the transferred property from other property of the transferor and designation by the transferor that the particular property is that which will be transferred.

3. *Ownership of a Copy.* Although separate from a transfer of ownership of informational rights, title to copies of the information may be important. In a license, under subsection (b)(2)(A), title to the copy depends on the terms of the contract. As in Article 2A, this article does not presume a transfer of title on delivery. The determination of intent on whether or not title to a copy transfers may require consideration of the entire terms of the transfer. See **Applied Information Management, Inc. v. Icart**, 1997 WL 535813 (EDNY March 3, 1997); **DSC Communications Corp. v. Pulse Communications, Inc.**, 1997 US Dist. LEXIS 10048 (ED Va. 1997).

4. *Reservation of Title.* Under subsection (b)(2)(C), a reservation of title in a copy extends that reservation to all copies made by the licensee. That presumption is altered if the license contemplates the licensee making copies for sale or other distribution. Thus, a license of a manuscript to a book publisher contemplating production of books and sale of the copies, does not reserve in the author title to all the books. This concept does not apply where the expectation is that the licensee will transfer copies by a further license.

5. *When Title to a Copy Passes.* Subsection (c) deals only with contracts where the parties agreed to transfer title to a copy. It states presumptions relating to when title passes to copies. The contract controls. Absent contract terms, the Section distinguishes between tangible and electronic transfers. The rule for tangible transfers of a physical copy parallels current Article 2. The electronic transfer approach defers to federal law. The White Paper on copyright in the Internet suggests and legislation is being considered to implement that the electronic delivery of a copy of a copyrighted work is not a first sale because it does not involve transfer of a copy **from** the licensor to the licensee.

SECTION 2B-502. TRANSFERS OF CONTRACTUAL INTERESTS.

Except as otherwise provided in Section 2B-503, the following rules apply:

(1) A contractual interest can be transferred unless the transfer:

(A) is prohibited under other applicable law; or

(B) would materially change the duty of the other party, materially increase the burden or risk imposed on the other party, disclose or threaten to disclose the other party's trade secrets, confidential information or information that is subject to an enforceable non-disclosure agreement, or materially impair the other party's property or its likelihood or expectation of obtaining return performance.

(2) Except as otherwise provided in paragraph (3), a contractual term prohibiting transfer of a party's interest is enforceable and a transfer made in violation of that contract term is a breach of contract and is ineffective except to the extent:

(A) the transfer is permitted in Section 2B-503; or

(B) the contract is a license that was granted for the purpose of incorporation or use of the licensed information or informational rights with information or informational rights from other sources in a combined work for public distribution or public performance and the transfer is of the completed combined work.

(3) A contract term prohibiting transfer of the right to payment under a license or a software contract is ineffective to prevent such transfer unless the transfer would be precluded under paragraph (1). A transfer precluded under this paragraph is a breach of contract and ineffective, but a transfer permitted under this paragraph is not a breach and is effective.

Uniform Law Source: Section 2A-303(2)(3)(4)(6)(8).

Definitional Cross References.

"Agreement": Section 1-201. "Contract": Section 1-201. "Copy": Section 2B-102. "Information": Section 2B-102. "Informational rights": Section 2B-102. "License": Section 2B-102. "Licensee": Section 2B-102. "Licensor": Section 2B-102. "Transfer". Section 2B-102.

Official Comments:

1. *General Enforceability. S*ubsection (1) generally provides that interests in a contract can be transferred, but limits that principle by reference to standards that protect the non-transferring party's interest. The language follows existing Article 2. The concepts here seem especially relevant to licensing where, in many transactions outside retail markets, important reliance and confidentiality interests are involved that may be compromised by a transfer of the contract. In practice, under federal law, many licenses may not be transferable without licensor consent even in the absence of a contract provision to that effect.

2. *Transfer.* This section, and other sections of Part 5 use the word "transfer" to what in many contexts is described as an "assignment of a contract." The term here does not refer to a "transfer of a copyright" or similar intellectual property interest. It does not refer to delegation of performance under a license. Delegation, which is covered in a later section, occurs when a third party performs the duties or rights of the licensee, while transfer (assignment) involves conveying those contract rights to the third party.

3. *Contractual Restrictions.* Subsection (2) validates contractual restrictions on the transfer of a contractual interest. This is consistent with both the underlying theme of this article recognizing contractual choice and with the importance of the retained interest of the licensor in a license arrangement. A transfer in violation of the contract restriction is ineffective. This rule is appropriate as a general principle, rather than merely allowing the term to create a breach, because of the important interests involved in the licensor's position in a license.

If the rule were otherwise (e.g., the prohibited transfer is effective, but a breach of contract), this would create a significant period in which the transferee would be protected by the license before it could be cancelled in litigation against the licensee. For example, assume a license for $5,000 that allows licensee (ABC, a small company) to make as many copies as needed for use in the licensee's

enterprise for employees. ABC has ten employees and the license is expressly not transferable. ABC transfers the license to AT&T, a much larger company with 50,000 employees.

If it had requested an enterprise license, the fee would have been $10,000,000. If the transfer is merely a breach, ATT may be licensed to make as many copies as it needs for its (as licensee) employees. Until licensor sues and obtains cancellation of the license against ABC, all copies made are non-infringing. In contrast, a rule making the prohibited transfer ineffective precludes the licensee from without permission going into competition with its licensor, having obtained a license based on the lower use expectations associated with the original licensee.

4. *Financier Interests.* As provided in Section 2B-503, a contract restriction on transfer is not fully enforceable with respect to creation of some financing arrangements.

5. *Payment Streams.* Subsection (3) allows transfer of payment streams despite a contrary contractual provision unless the transfer of the payment stream would make a material change of the other party's position. In cases where Article 9 applies to the purported transfer, this leave unaffected the Article 9 rule that, in itself, the contract term cannot preclude such transfer, while also preserving the underlying rule of law that precludes transfers that materially harm the other party.

2B-503. FINANCIER'S INTEREST IN A LICENSE.

(a) The following rules apply to the creation, perfection, and enforcement of a financier's interest in a licensor's contractual interest in a license:

(1) Except as provided in paragraph (2) and (3), a financier's interest may be created or perfected notwithstanding Section 502(1) or any contractual provision. The financier's interest thus created or perfected:

(A) does not place any obligations on or alter the rights of the licensee; and

(B) is subject to all terms and conditions of the license.

(2) Notwithstanding paragraph (1), no financier's interest can be created or perfected to the extent that the interest purports to include intellectual property rights of the licensee, unless the licensee expressly consents to the interest in a record.

(3) Unless precluded by Section 2B-502(1) or by a term of the license, the financier whose interest is created under this subsection may enforce its interest pursuant to Article 2A, Article 9 or other law as applicable.

(b) The following rules apply to the creation, perfection, and enforcement by a financier, other than the licensor, of an interest in a licensee's rights under a non-exclusive license:

(1) A financier's interest may be created and perfected notwithstanding Section 2B-502(1) or any contrary provision of the license. The interest thus created or perfected:

(A) does not entitle the financier to make an actual change of use, possession or control unless transfer is permitted under Section 2B-502(2)(B);

(B) does not place any obligations on or alter the rights of the licensor; and

(C) is subject to all terms and conditions of the license.

(2) Notwithstanding paragraph (1), no financier's interest can be created or perfected to the extent that the interest purports to attach to any intellectual property rights of the licensor unless the licensor expressly consents to the creation and perfection of that interest in the license or another record.

(3) The financier may not enforce its interest by taking possession or control, using, selling or taking any other action with respect to the licensed information, the informational rights, or the contractual rights without the licensor's express consent in **the license or another** record unless transfer is permitted under Section 2B-502(2)(B).

(c) A transfer **or enforcement** precluded under subsection (a) or (b) is a breach of contract and ineffective, but a transfer **or enforcement** permitted under subsection (a) or (b) is not a breach and is effective.

(d) The following rules apply with respect to the termination or cancellation of a license to which a financier's interest applies:

(1) Without interference by the financier, the licensor or licensee may cancel or terminate the license in accordance with its terms or applicable law without any liability or duties to the financier unless the person that

seeks to cancel or terminate previously agreed with the financier to waive such right.

(2) Cancellation or termination of the license terminates the financier's interest in the license.

(3) On demand made in a record by a licensor or licensee after cancellation or termination of the license, the financier shall promptly amend or otherwise cause the removal of all filings or recordings indicating an interest in the license and shall be liable for any loss arising out of any failure to do so in a timely manner.

Definitional Cross References.

"Contract": Section 1-201. "Financier": Section 2B-102. "Information": Section 2B-102. "Informational rights": Section 2B-102. "License": Section 2B-102. "Licensee": Section 2B-102. "Licensor": Section 2B-102. "Nonexclusive license": Section 2B-102. "Party": Section 1-201. "Term": Section 1-201. "Transfer": Section 2B-102.

Official Comments:

1. *General Rule.* This Section deals with the ability of a financier to obtain an interest in contractual rights. It distinguishes between financing of a licensor's interest and financing of a licensee's interest in a non-exclusive license. The provisions coordinate with Article 9 treatment of licenses.

In determining the applicable rights, a further distinction is made between the act of creating a security interest and the act of enforcing that interest. This section allows creation of an interest, except in the other party's intellectual property rights, in essentially all cases. For non-exclusive licenses, however, it does not permit enforcement of that interest without the licensor's consent. Unlike in sales of goods, licenses create a situation where three parties have an interest in what happens to the property and the contractual rights associated with it: the lender, the debtor and the licensor. In many cases, the licensor's property rights dominate. In dealing with these three parties, a material difference may exist between creation of a non-possessory interest and enforcement by repossession, foreclosure, or sale or by creation of a non-possessory interest.

2. *Non-exclusive Licenses.* For non-exclusive licenses, the transferability of a licensee's rights is constrained in law by federal policy limitations that presume non-transferability without licensor consent. See 2B-502(1). See **Everex Systems, Inc. v. Cadtrak Corp.,** 89 F.3d 673 (9th Cir. 1996). See also **In re Patient Education Media, Inc.,** 210 BR 237 (Bankr. SD NY 1997) (copyright license). It is also constrained by a general state law policy, reflected in Article 2A, that in three party transactions of this type, the rights owner is entitled to protection.

Article 2A-303(3) limits the enforceability of lease provisions restricting security interests, stating: "[The] lessor is entitled to protect its residual interest in the goods by prohibiting anyone other that the lessee from possessing or using them." Article 2A-303, *Comment* 3. As in Article 2A, the licensor has a right to control who is in effective possession (including use and access) of the subject matter of the license. This policy has been enforced by a number of courts in reference to assignments of a licensee interest to third parties, either by contract or by operation of law.

This Section assumes that the licensor's interests are protected so long as there is no actual transfer of possession or control without its consent.

3. *Taking Subject to the License.* The financier and any transferee take subject to the limiting terms of the license and the intellectual property rights of the other party. The license is the dominant agreement in that it defines the licensee's rights. This does not mean that the transferee undertakes or is bound by affirmative obligations, such as any duty to pay royalties. However, if through non-payment or otherwise, a breach occurs and the license is cancelled, the cancellation vitiates the financier's rights.

2B-504. EFFECT OF TRANSFER OF CONTRACTUAL RIGHTS.

(a) A transfer of "the contract" or of "all my rights under the contract", or a transfer in similar general terms, is a transfer of all contractual rights. Whether the transfer is effective is determined under Sections 2B-502 and 2B-503.

(b) The following rules apply to a transfer of a party's contractual rights:

(1) The transferee is subject to all contractual use restrictions.

(2) Unless the language or circumstances indicate the contrary, as in a transfer for security, the transfer is a delegation of performance of the duties of the transferor which is subject to Section 2B-505.

(3) Acceptance of the transfer constitutes a promise by the transferee to perform the delegated duties. The promise is enforceable by the transferor and any other party to the original contract.

(4) The transfer does not relieve the transferor of any duty to perform, or of liability for breach of contract, unless the other party to the original contract agrees that the transfer has that effect.

(b) A party to the original contract other than the transferor may treat any transfer that delegates performance without its consent as creating reasonable grounds for insecurity and without prejudice to its rights against the transferor may demand assurances from the transferee pursuant to Section 2B-620.

Uniform Law Source: 2-210; 2A-303.

Definitional Cross References.

"Contract": Section 1-201. "Contractual use restriction": Section 2B-102. "Party": Section 2B-102. "Rights": Section 1-201. "Transfer": Section 2B-102. "Term". Section 1-201.

Official Comments:

1. This section conforms to current Article 2 and Article 2A.

2. The recipient of a transfer is bound to the terms of the original contract and that obligation can be enforced either by the transferor or the other party to the original contract. An effective transfer of contractual rights constitutes a transfer of those rights and, a delegation of duties if accepted by the transferee.

3. Subsection (b) also follows current law and provides that the transfer does not alter the transferor's obligations to the original contracting party in the absence of a consent to the novation.

2B-505. DELEGATION OF PERFORMANCE; SUBCONTRACT.

(a) A party may perform its contractual duties through a delegate or pursuant to a subcontract unless:

(1) the contract prohibits delegation or subcontracting; or

(2) the other party has a substantial interest in having the original promissor perform or control the performance.

(b) Delegation or subcontract of performance does not relieve the party delegating the performance of a duty to perform or of liability for breach of contract.

Uniform Law Source: Section 2-210; Section 2A-303.

Definitional Cross References.

"Contract": Section 1-201. "Party": Section 2B-102.

Official Comments:

1. *Nature of Delegation.* Delegation or subcontracting of performance refers to a party's ability to use a third party in making an affirmative performance under a contract. Compare "transfer" defined in 2B-102. While the performance may be by the delegate, the original party remains bound by the contract and responsible for any breach.

2. *Effect of Contract.* The ability to delegate is subject to contrary agreement. Thus, a contract that permits use of licensed information only by a named person or entity controls and precludes delegation.

3. *Delegation in the Absence of a Contract Restriction.* In the absence of a contractual limitation, delegation can occur unless the other party has a substantial interest in having the original promissor perform or control the performance. Obviously, a party has a substantial interest in having the original party perform if the delegation triggers the restrictions in 2B-502, but may also have such an interest in other cases.

2B-506. PRIORITY OF TRANSFER BY LICENSOR.

(a) A licensor's transfer of ownership of informational rights is subject to any nonexclusive license that is enforceable under Section 2B-201 and made prior to the transfer.

(b) Except as otherwise provided by federal intellectual property law, a nonexclusive license has priority over the interest of the licensor's financier in information or informational rights if the license was:

(1) authorized by the financier;

(2) made in a record authenticated by the licensor before the creation of the financier's interest; or

(3) transferred in the ordinary course of the licensor's business to a licensee that acquired the license in good faith and without knowledge that it was in violation of the financier's interest.

Uniform Law Source: Section 2A-304. Revised.

Definitional Cross References:

"Authenticate": Section 2B-102. "Financier": Section 2B-102. "Good faith": Section 2B-102. "Information": Section 2B-102. "Informational rights": Section 2B-102. "License": Section 2B-102. "Licensee": Section 2B-102. "Licensor": Section 2B-102. "Nonexclusive license": Section 2B-102. "Record": Section 2B-102. "Transfer": Section 2B-102.

Official Comments:

1. *Background.* This is an area heavily influenced by federal copyright law as to copyright interests. The rules here trace that influence while providing maximum state law recognition for traditional UCC priorities. As to transfers of ownership and, arguably, security interests, federal law may preempt state law in reference to federal intellectual property rights. There is no such preemption on preemption for data, trade secrets and other non-federal rights.

Subsection (a) deals with general priorities. Subsection (b) deals with the priority of a security interest in conflict with a non-exclusive license.

2. *Prior Oral Licenses.* Subsection (a) grants priority to a prior license that is enforceable under the statute of frauds in 2B-201. This parallels but does not fully conform to copyright law. It creates a state law priority system with reference to the coverage allowed to state law. The rule governs as to data, access contracts, trade secrets and other information are not within the Copyright Act. The Copyright Act gives priority to licenses in a signed writing. To the extent inconsistent with this Section as to copyright subject matter, that rule governs.

3. *Security Interests and Licenses.* Subsection (b) deals with priority between a security interest and a license. While there are preemption issues here, the case for preemption is less strong since the UCC generally controls law relating to security interests. Federal concerns in the priority statute are more focused on title transfers. This section adopts priority rules that parallel priority positions in current Article 9. The goal is to facilitate use of secured lending related to intangibles by creating provisions that enable the licensor to continue to do business in ordinary ways.

This Section does not deal with conflicting transfers of informational rights ownership.

4. *Preemption Issues.* For rights not created under federal law, priority issues are questions of state law. The same is true for non-ownership rights in patent. The situation is different in copyright law. Section 205(f) of the Copyright Act provides:

> A nonexclusive license, whether recorded or not, prevails over a conflicting transfer of copyright ownership if the license is evidenced by a written instrument signed by the owner of the rights licensed or such owner's duly authorized agent, and if:
>
> (1) the license was taken before execution of the transfer; or
>
> (2) the license was taken in good faith before recordation of the transfer and without notice of it.

17 U.S.C. 205(f). There is no case law under this provision.

This provision of the Copyright Act can be viewed either as a comprehensive rule of priority (e.g., unwritten license is never superior to transfer of ownership; priority of a written license entirely controlled by Section 205(f)), or as a minimum condition for a particular result (e.g., that a written nonexclusive license has priority under specified circumstances, but not suggesting that these are the only conditions under which this is true). This Article adopts the view that the priority rule states a minimum and does not establish a comprehensive rule. Thus, a nonexclusive license prevails in the listed situations, but priority of a nonexclusive license in cases not covered by Section 205 is not controlled by federal law.

2B-507. TRANSFERS BY LICENSEE.

(a) If all or any part of a licensee's interest in a license is transferred, voluntarily or involuntarily, the following rules apply:

(1) The transferee acquires no interest in information, copies, or the contractual or informational rights of the licensee unless the transfer is permitted under Sections 2B-502 and 2B-503.

(2) If the transfer is effective under subsection (a)(1), the transferee takes subject to the terms of the license.

(b) Except as otherwise provided under trade secret law, a transferee that acquires information that is subject to the informational rights of a third party acquires no more rights than the contractual rights that its transferor was authorized to transfer.

Uniform Law Source: Section 2A-305

Definitional Cross References.

"Information": Section 2B-102. "Informational Rights": Section 2B-102. "License": Section 2B-102. "Licensee". Section 2B-102. "Party": Section 2B-102. "Rights": Section 1-201. "Transfer". Section 2B-102. "Term". Section 1-201.

Official Comments:

1. *Transferee Interests: General.* A license governs rights in the information and copies. Subsection (a) provides that a transferee of the licensee acquires only the rights that the license and the provisions of this Article on transferability allow.

2. *Transfers and Underlying Property Rights.* Subsection (b) states the rule that a transferee of a licensee acquires only those rights that the licensee was authorized to transfer. This is an important principle of intellectual property law which differs from transactions involving the sale of goods. A transferee who takes a transfer not authorized by the underlying rights holder does not acquire greater rights than its transferee was authorized to transfer, even if the acquisition was in good faith and without knowledge.

The ideas of entrustment and bona fide purchase, which play a role in dealing with title to goods, have no similar role in intellectual property law. Neither copyright nor patent recognize ideas of protecting a buyer in the ordinary course (or other good faith purchaser) by giving that person greater rights than were authorized to be transferred. Copyright law allows for a concept of "first sale" which gives the owner of a copy various rights to use that copy, but the first sale must be authorized.

Transfers that exceed a license or that otherwise are unlicensed and unauthorized by a patent or copyright owner create no rights of use in the transferee. A transferee that takes outside the chain of authorized distribution does not benefit from ideas of good faith purchase, but its use is likely to constitute infringement. See **Microsoft Corp. v. Harmony Computers & Electronics, Inc.,** 846 F. Supp. 208 (ED NY 1994); **Major League Baseball Promotion v. Colour-Tex**, 729 F. Supp. 1035 (D. N.J. 1990); **Microsoft Corp. v. Grey Computer**, 910 F. Supp. 1077 (D. Md. 1995); **Marshall v. New Kids on the Block**, 780 F. Supp. 1005 (S.D.N.Y. 1991).

3. *Trade Secret and Unprotected Information.* The rule in subsection (b) allows for a bona fide purchaser in reference to trade secret claims. These are state law property rights. A trade secret enforces confidentiality. If a party takes without notice of such restrictions, it is not bound by them; it is in effect a good faith purchaser, free of any obligations regarding infringement except as such exist under copyright, patent and similar law.

PART 6

PERFORMANCE

[A. General]

2B-601. PERFORMANCE OF CONTRACT IN GENERAL.

(a) A party shall perform in a manner that conforms to the contract.

(b) A party has no duty to perform, other than with respect to contractual use restrictions, if there is an uncured material breach by the other party which precedes in time the aggrieved party's performance.

(c) Tender of performance entitles a party to acceptance of that performance. A tender of performance occurs when a party, with manifest present ability and willingness to do so, offers to complete the performance. If a performance by the other party is due at the same time as the tendered performance, tender of the other party's performance is a condition to the tendering party's obligation to complete its tendered performance.

(d) A party may refuse a performance that is a material breach as to that performance or if refusal is permitted under Section 2B-609(b). The aggrieved party may cancel the contract only if the breach is a material breach of the entire contract or the agreement so provides.

(e) A party shall pay or render any consideration required under the agreement for any performance it accepts. The burden is on the party that accepted the performance to establish a breach of contract with respect to the performance accepted.

(f) Except as otherwise provided in Sections 2B-603 and 2B-604, in the case of a performance with respect to a copy, Sections 2B-606 through 2B-614 also apply. In the event of a conflict, the provisions of those sections prevail over this section.

Uniform Law Source: Restatement (Second) of Contracts ? 237. Substantially revised.

Definitional Cross References.

"Aggrieved party": Section 1-201. "Agreement": Section 1-201. "Cancel": Section 2B-102. "Contract": Section 1-201. "Contractual use restriction": Section 2B-102. "Copy": Section 2B-102. "Party": Section 2B-102.

Official Comments:

1. *General Approach.* This section brings together a number of general principles pertaining to performance of a contract. The provisions of the Section are supplanted by sections on tender and acceptance (or refusal) of copies. The general approach follows the **Restatement (Second) of Contracts** and uses a concept of material breach to determine what remedies arise for an aggrieved party other than in the mass market where a standard of fully conforming tender applies.

2. *Duty to Conform.* Subsection (a) states that a party must conform to its contract. Any failure to conform gives the aggrieved party a remedy subject to concepts of waiver and contrary terms of the contract.

3. *Material Breach: General Standard.* Subsection (b) adopts the **Restatement** and common law doctrine of material breach. The duty to perform is contingent on the absence of a prior material failure of performance by the other party. **Restatement (Second) of Contracts** 237.

The concept is simple: a minor (immaterial) defect in performance does not warrant rejection or cancellation of a contract. While minor problems constitute a breach, the remedy lies in recovery of damages. The policy avoids forfeiture for small errors. Especially if performance involves ongoing activity, fully perfect performance cannot be expected as a default rule. If the parties desire to create a more stringent standard, they must do so by the terms of their agreement. A licensor that receives imperfect performance cannot cancel the contract on account of a minor problem.

The contingent relationship does not refer to contractual use restrictions. A breach does not allow a party to ignore contract restrictions on use. This is true even if there is a duty to mitigate loss. The use restrictions trump or limit any duty to mitigate since they define what the party can do in use of the information. A breach by the licensor does not give the licensee unfettered rights to act in derogation of use restrictions that are often buttressed by intellectual property rights.

Article 2 and Article 2A stand alone in modern contract law in not using material breach theory (requiring so-called "perfect tender") but do so in only a single fact situation: a single delivery of goods not part of an installment contract. Article 2B creates a rule parallel to Article 2 for single delivery, mass-market transactions.

Additionally, the "perfect tender" rule is a misnomer even when applicable under Article 2. Even in a single delivery context, the idea that a performance must conform to the contract is hemmed in by a myriad of countervailing legal considerations. As White and Summers state: "[we have found no case that] actually grants rejection on what could fairly be called an insubstantial non-conformity . . ."

3. *Material Breach: Mass Market.* As described in Section 2B-609(b), Article 2B does not apply the material breach theme to mass market transactions involving tender of delivery of a copy other than in an installment contract setting. This follows current Article 2. As in Article 2, the rule applies only to tender of a copy and the resulting duty to accept or right to refuse the tender that is the vendor's sole performance (e.g., delivery of a television set, delivery of the diskette containing the software).

5. *Duty to Accept and Tender.* Subsection (c) brings together general rules from the Restatement and current Article 2 regarding sequencing of performance. It is subject to the more specific rules on tender and acceptance of copies in this Article.

The primary principle is that tender of performance entitles the tendering party to acceptance of that performance. The rule is stated in general terms here. Of course, if the tendered performance is a material breach, under subsection (b), the party receiving the tender is not required to perform its obligation.

6. *Refusing a Performance and Cancellation.* An important distinction exists between the right to refuse a particular performance and the right to cancel the entire contract. That distinction is more central in Article 2B than in Article 2 because of the nature of the contracts involved.

A party may refuse a particular performance if the performance itself fails to conform to the contract and consists of a material breach **as to that performance.** Whether that breach and the resulting refusal also allows the party to cancel the entire contract depends on whether the breach is material as to the

entire contractual relationship. In cases where the entire performance consists of a delivery of a single copy, of course, the right to refuse that copy corresponds to the right to cancel the contract. In more complex situations, however, a single breach may not be material to the whole relationship. Thus, for example, a payment that is only one-half the required amount is most likely a material breach as to that payment, but whether it also constitutes a material breach of the entire contract depends on the circumstances and the terms of the contract.

2B-602. LICENSOR'S OBLIGATIONS TO ENABLE USE.

(a) In this section, to "enable use" means to grant a contractual right or permission with respect to information or informational rights and complete the acts, if any, required under the agreement to make the information available to the a party.

(b) A licensor shall enable use by the licensee. The following rules apply to enable use:

(1) If nothing other than the grant of a contractual right or permission is required to enable use, the licensor enables use when the contract becomes enforceable between the parties.

(2) In an access contract, to enable use requires providing access material necessary to obtain the agreed access.

(3) If a filing or recording of a record is allowed by law to establish priority of ownership of informational rights and the agreement requires a transfer of ownership of informational rights previously owned by the licensor, the licensor shall deliver a record for that purpose on request by the licensee.

Definitional Cross Reference:

"Access contract": Section 2B-102. "Access material": Section 2B-607. "Agreement": Section 1-201. "Contract": Section 1-201. "Information": Section 2B-102. "Informational Rights": Section 2B-102. "Licensee". Section 2B-102. "Licensor": Section 2B-102. "Record": Section 2B-102. "Rights": Section 1-201.

2B-603. SUBMISSIONS OF INFORMATIONAL CONTENT: PERFORMANCE. If a party submits informational content pursuant to an agreement that requires that the informational content be to the satisfaction of the recipient, the following rules apply:

(1) Sections 2B-606 through 2B-614 do not apply to the submission.

(2) If the informational content is not satisfactory to the recipient, the parties may engage in efforts to correct the deficiencies in a manner and over a period of time consistent with the ordinary standards of the business, trade or industry without the efforts or the passage of time being treated as acceptance or refusal of the submission.

(3) Neither refusal nor acceptance of the informational content occurs unless the recipient expressly refuses or accepts the submission.

Definitional Cross References.

"Agreement": Section 1-201. "Informational content": Section 2B-102. "Party": Section 2B-102.

Official Comments:

1. *General Purpose.* Article 2 rules on tender, acceptance and rejection of goods are not appropriate in many information transactions. This Section deals with one such context: information submitted under an agreement that the submission be to the satisfaction of the receiving party. Such transactions are common in all information industries.

The submission triggers a process that centers around the fact that the recipient has the right to refuse if the submission does not satisfy its expectations, but that immediate acceptance or rejection is often not expected. A process of revision and tailoring occurs. Subsection (a) defines basic principles in such cases.

2. *Express Choices.* An important aspect of the context lies in subsection (3) where it is made clear that only an explicit refusal or acceptance satisfies the standard of acceptance in this setting since the circumstances are keyed to the subjective satisfaction of the receiving party.

2B-604. IMMEDIATELY SELF-COMPLETED ING PERFORMANCES. If a performance by a licensor, because of its nature, provides a licensee with substantially all the benefit of the performance or other significant benefit immediately on performance or delivery and the benefit cannot be returned after it is received, the following rules apply:

(1) Sections 2B-606 through 2B-614 do not apply.

(2) The rights of the parties are determined under Section 2B-601 and the ordinary standards of the business, trade, or industry.

(3) Before tender of the performance, a party may inspect the media and labels or packaging but may not view the information or otherwise receive the performance before completing any performance of its own that is due at that time unless the agreement so provides.

Definitional Cross Reference:

"Agreement": Section 1-201. "Delivery": Section 2B-102. "Information": Section 2B-102. "Licensee". Section 2B-102. "Party": Section 2B-102. "Rights": Section 1-201.

Official Comments:

This section deals with a problem arising from the nature of the subject matter covered in this article. Some subject matter is, in effect, fully delivered when made available to or read by the transferee; theories of inspection, rejection and return as in Article 2 are not applicable. This is true, for example, in a pay per view arrangement for an entertainment event or other information. It is also the case where the subject matter of the contract involves informational content that, once seen, has in effect communicated its entire value. The parties are left to the general rules of Section 2B-601.

2B-605. WAIVER OF REMEDY FOR BREACH OF CONTRACT.

(a) A claim or right arising out of a breach of contract may be discharged in whole or in part without consideration by a waiver contained in a record to which the party agrees after breach, by manifesting assent or otherwise.

(b) A party that accepts a performance with knowledge that the performance constitutes a breach of contract waives all remedies for the breach if it fails within a reasonable time after acceptance to notify the other party of the breach.

(c) Except for a failure to meet a requirement that performance be to the satisfaction of a party, a party that refuses a performance and fails to state in connection with its refusal a particular defect that is ascertainable by reasonable inspection waives the right to rely on that defect to justify refusal if:

(1) the other party could have cured the defect if it had been stated seasonably; or

(2) between merchants, the other party after refusal made a request in a record for a full and final statement in a record of all defects on which the refusing party proposes to rely.

(d) Waiver of a remedy for breach of contract in one performance does not waive the same or a similar breach in future performances unless the party making the waiver expressly so states.

(e) A waiver may not be retracted as to the performance to which the waiver applies. However, except for a waiver in accordance with subsection (a) or a waiver supported by consideration, a waiver affecting an executory portion of a contract may be retracted by seasonable notice received by the other party that strict performance will be required in the future of any term waived, unless the retraction would be unjust in view of a material change of position in reliance on the waiver by the other party.

Definitional Cross Reference:

"Contract": Section 1-201. "Manifest assent": Section 2B-111. "Merchant": Section 2B-102. "Notice": Section 1-201. "Notify": Section 1-201. "Party": Section 1-201. "Receive": Section 2B-102. "Record": Section 2B-102. "Rights": Section 1-201. "Term". Section 1-201.

Official Comments:

1. *General Rule.* A "waiver" is the voluntary relinquishment of a known right. Conduct and words may constitute a waiver. This section brings together rules from various portions of Article 2 dealing with waiver issues and recasts those rules to fit the broader variety of types of performance involved in Article 2B transactions. The section also applies principles from the **Restatement**.

2. *Waivers in a Record.* Subsection (a) stems from 2A-107. Waivers contained in a record under common law and this Article are enforceable without consideration. . See **Restatement (Second)** 277. Subsection (a) does not preclude other ways of making an effective waiver, but merely confirms that waivers that meet its provisions are effective. For example, an oral waiver, if effective under common law of a state, remains effective.

This subsection does not require delivery of the record to the party making the waiver.

3. *Waiver by Accepting a Performance.* Subsection (b) and (c) deal with waivers made by accepting the performance of the other party without objecting to known defects. Waiver is implied from the

combination of knowledge and silence beyond a reasonable time after accepting the performance. The rule does not apply if the party merely knows that performance is not consistent with the contract. The performance must have been tendered to and accepted by it. The following illustrates the rule:

Illustration: Licensee has an obligation to pay royalties based on 2% of the sale price of products licensed for distribution. The royalty payments must be received on the first of each month. A 5% late fee is imposed for delays of more than five days and the license provides that delay of more than five days is a material breach. In one month, the licensee does not tender payment until the 25th day of the month and its tender does not include the late charge. Licensor may refuse the tender and cancel the contract. If it accepts a tender it knows to be a breach, it cannot thereafter cancel the contract **for that breach.** If it fails to object in a reasonable time to the late tender and the nonpayment of the late fee, it is also barred from recovering that fee.

4. *Waiver by Failure to Particularize.* Subsection (c) implies a waiver from a failure to particularize the reason for a refusal of a performance, but only in a limited number of circumstances. A failure to particularize is a waiver if the other party could have cured the problem had it known of the basis for refusal. Additionally, in the case of a contract between merchants, waiver occurs when the breaching party asks for a specification in writing of the reasons for refusal and a basis for that refusal is not listed among the given reasons. This generalizes the language of Section 2-605.

5. *Executory and Waived Performances.* Under Subsection (d), unless the intent is express or the circumstances clearly indicate to the contrary, a waiver applies only to the specific breach waived. This principle does not alter estoppel concepts; a waiver may create justifiable reliance as to future conduct in an appropriate case.

Subsection (e) comes from current UCC Article 2 setting out when waiver as to executory obligations can be retracted. On the treatment of waivers supported by consideration, see **Restatement (Second) of Contracts** ? 84, comment f.

2B-606. CURE OF BREACH OF CONTRACT.

(a) A party in breach of contract may cure the breach at its own expense if:

(1) the time for performance has not yet expired, the party seasonably notifies the aggrieved party of its intention to cure, and, within the agreed time for performance, the party makes a conforming performance;

(2) the party in breach had reasonable grounds to believe the performance would be acceptable with or without money allowance, seasonably notifies the other party of its intent to cure, and provides a conforming performance within a further reasonable time after the agreed time for performance; or

(3) in cases not governed by paragraph (1) or (2), the party seasonably notifies the aggrieved party of its intent to provide a conforming performance and promptly does so before cancellation by the aggrieved party.

(b) In a license other than a mass-market license, in the case of tender of a nonconforming copy that was the initial act to enable use, the party was required to accept because the nonconformity was not a material breach, the party in breach shall promptly and in good faith make an effort to cure if:

(1) the party in breach receives timely notice of a specified nonconformity and a demand for cure; and

(2) the cost of the effort to cure is not disproportionately larger than the direct damages caused by the nonconformity to the aggrieved party.

(c) A party may not cancel a contract or refuse a performance because of a breach of contract that has been cured. However, notice of intent to cure does not preclude cancellation or refusal.

Uniform Law Source: Sections 2-508; 2A-513

Definitional Cross References.

"Aggrieved party": Section 1-201. "Cancellation": Section2B-102. "Contract": Section 1-201. "Copy": Section 2B-102. "Direct damages": Section 2B-102. "Enable use": Section 2B-602. "Good faith": Section 2B-102. "License": Section 2B-102. "Mass-market license": Section 2B-102. "Material breach": Section 2B-109. "Notice": Section 1-201. "Notifies: Section 1-201. "Party": Section 2B-102. "Receive": Section 2B-102.

Official Comments:

1. *General Application.* This section gives both the licensor or the licensee (whichever is in breach) an opportunity to cure under the stated conditions. For licensees cure often relates to missed payments, failures to give a required accounting or other report, and misuse of information. For licensors, the issues often focus on timeliness of performance, adequacy of product, and the like.

The idea that a breaching party may, if it acts promptly and effectively, eliminate the effect of its breach and preserve the contract is embedded in modern law. See, e.g., **Restatement (Second) of Contracts** ? 237. However, there is significant disagreement about the scope of the right.

a. The UNIDROIT Principles go the furthest in establishing a **right** to cure providing that cure is not precluded by termination for breach and by not limiting the right to cure in any manner related to the timing of the performance. The UNIDROIT Principles condition cure on "prompt" action and if "appropriate in the circumstances" and if the other party has no "legitimate interest" in refusing cure. UNIDROIT art. 7.1.4

b. Article 2 distinguishes between cure made within the original time for performance (essentially a right to cure) and cure occurring afterwards (restricted to cases where vendor expected the tender to be acceptable).

c. The UN **Sales Convention** does not distinguish between cure within or after the original agreed date for performance. It allows the seller to cure if it can do so without unreasonable delay and without causing the buyer unreasonable inconvenience or uncertainty. **Sales Convention** art. 48. However, the cure right is subject to the party's right to declare the contract "avoided" if the breach was a fundamental breach of contract.

2. *Right to Cure.* This Section allows cure if it is prompt. The proposed language follows existing Article 2 in creating a right to cure if cure occurs before the end of the contract period for the performance or if there was a prompt cure after a reasonable expectation that the performance would be acceptable.

3. *Permissive Cure.* In all other cases, cure is subject to prior cancellation by the other party. This places control in the aggrieved party who suffered a material breach. In the mass market and in other cases of contracts involving rights in a copy of information, refusal of the tender of the copy may constitute cancellation because the entire transaction focused on providing rights associated with a copy. In such cases, no special notice or words of cancellation are required.

As indicate in subsection (c), the aggrieved party is not required to withhold cancellation because of a notice of intent to cure received from the other party.

4. *Obligation to Cure.* Subsection (b) applies to cases where the licensee is required to accept a performance because the material breach standard is not met even though some defect exists. It creates an obligation to attempt a cure. Failure to undertake the effort is a breach, but if the effort occurs and fails, there is no **additional** breach of contract. The obligation to cure is limited by a concept of proportionality. No obligation arises if it would entail costs disproportionate to the direct damages caused by the nonconformity. Thus, for example, if a party delivers a one thousand name list for $500 that omits five **non-material** names reducing the value of the list by a small amount, it has no obligation to cure if obtaining those additional names would cost $1,000. The proper remedy is the difference in value If any) of the copy rendered and the performance promised.

[B. Performance in Delivery of Copies]

2B-607. TENDER OF DELIVERY OF COPY.

(a) In this section, "access material" means any documents, authorizations, addresses, access codes, acknowledgments, or other materials necessary for a party to obtain authorized access to, control, or possession of a copy.

(b) Tender of delivery of a copy requires that the tendering party put and hold a conforming copy at the other party's disposition and give the other party any notice reasonably necessary to enable it to obtain access, control, or possession of the copy. Tender must be at a reasonable hour and, if applicable, requires the tendering party to tender access material and any other document required by the agreement or by usage of trade. The party receiving the tender shall furnish facilities reasonably suited to receive tender.

(c) Except as otherwise provided in subsections (d), (e), and (f), the following rules apply:

(1) The place for tender of a copy on a physical medium is the tendering party's place of business or, if it has none, its residence. However, if the parties know at the time of contracting that the copy is located in some other place, that place is the place for its tender of delivery.

(2) In an electronic delivery of a copy, tender requires that the tendering party make the information available in an information processing system designated by it.

(3) Documents of title may be delivered through customary banking channels.

(d) If the contract requires delivery of a copy held by a third person without being moved, the tendering party shall tender the material and other documents as provided in subsection (c).

(e) If the tendering party is required to send a copy to the other party and the contract does not require the tendering party to deliver the copy at a particular destination, the following rules apply:

(1) In a delivery of a copy on a physical medium, the tendering party shall put the copy in the possession of a carrier and make a contract for its transportation which is reasonable having regard to the nature of the information and other circumstances, with expenses of transportation to be borne by the other party.

(2) In an electronic delivery of a copy, the tendering party shall initiate a transmission that is reasonable having regard to the nature of the information and other circumstances, with expenses of transportation to be borne by the other party.

(f) If the tendering party is required to deliver a copy at a particular destination, that party shall make a copy available at that destination, with expenses of transportation to be borne by it.

(g) If performance requires delivery of a copy:

(1) The party required to deliver shall tender delivery first but need not complete the delivery until the other party tenders any performance required at that time.

(2) If payment is due on delivery of a copy, the following rules apply:

(i) Tender of delivery of a copy is a condition of the other party's duty to accept the copy and of that party's duty to pay.

(ii) Tender entitles the tendering party to acceptance of the copy and payment according to the contract.

(iii) All copies called for by a contract must be tendered in a single delivery and payment is due only on the tender.

(3) If the circumstances give either party the right to make or demand delivery in lots, the contract fee, if it can be apportioned, may be demanded for each lot.

(4) If payment is due and demanded on delivery of a copy or on delivery of a document of title, the right of the party receiving tender to retain or dispose of the copy or document as against the tendering party is conditional on making the payment due.

Definitional Cross References.

"Agreement": Section 1-201. "Contract": Section 1-201. "Contract fee": Section 2B-102. "Copy": Section 2B-102. "Delivery": Section 2B-102. "Electronic": Section 2B-102. "Information": Section 2B-102. "Information processing system": Section 2B-102. "Notice": Section 1-201. "Party": Section 2B-102. "Receive": Section 2B-102. "Rights": Section 1-201. "Send". Section 2B-102. "Term". Section 1-201.

Official Comments:

This composite section corresponds to Article 2.

2B-608 RIGHT TO INSPECT; PAYMENT BEFORE INSPECTION.

(a) Except as otherwise provided in Sections 2B-603 and 2B-604, if performance requires delivery of a copy, the following rules apply:

(1) Except as otherwise provided in this section, the party receiving the copy has a right to inspect at a reasonable place and time and in a reasonable manner in order to determine conformance to the contract before payment or acceptance.

(2) Expenses of inspection must be borne by the party making the inspection.

(3) A place or method of inspection or an acceptance standard fixed by the parties is presumed to be exclusive. However, the fixing of a place, method, or standard does not postpone identification to the contract or shift the place for delivery or for passing of title or the risk of loss. If compliance with the place or method becomes impossible, inspection must be made as provided in this section unless the place or method fixed by the parties was an indispensable condition whose failure avoids the contract.

(4) A party's right to inspect is subject to any existing obligations of confidentiality.

(b) If a right to inspect exists under subsection (a) but the agreement is inconsistent with an opportunity to inspect before payment, the party does not have a right to inspect before payment.

(c) If the contract requires payment before inspection of a copy, nonconformity in the tender of the copy does not excuse the party receiving the tender from making payment unless:

(1) the nonconformity appears without inspection and would justify refusal under Section 2B-609; or

(2) despite tender of the required documents, the circumstances would justify an injunction against honor of a letter of credit under Article 5.

(d) Payment made under the circumstances described in subsection (b) or (c) is not an acceptance of the copy and does not impair a party's right to inspect or preclude any of the party's remedies.

Uniform Law Source: CISG art. 58(3); Section 2-512; 513. Revised.

Definitional Cross Reference:

"Agreement": Section 1-201. "Contract": Section 1-201. "Copy": Section 2B-102. "Delivery": Section 2B-102.

"Party": Section 2B-102. "Rights": Section 1-201.

2B-609. REFUSAL OF DEFECTIVE TENDER.

(a) Subject to subsection (b) and Sections 2B-610 and 2B-611, if a tender of delivery of a copy constitutes a material breach of contract as to the particular delivery, the party to which it is tendered may:

(1) refuse the tender;

(2) accept the tender; or

(3) accept any commercially reasonable units and refuse the rest.

(b) In a mass-market license, a licensee may refuse a tender of delivery of a copy if the contract calls only for a single tender and the copy or tender fail in any respect to conform to the contract. The refusal cancels the contract.

(c) Refusal is ineffective unless it is made before acceptance and within a reasonable time after tender or completion of any permitted effort to cure and the refusing party seasonably notifies the tendering party.

(d) Except as otherwise provided in subsection (b), an aggrieved party that refuses tender of a copy may cancel the contract only if the breach is a material breach of the entire contract or the agreement so provides.

Uniform Law Source: Combines 2-601, 2-602, 2A-509. Revised.

Definitional Cross References.

"Aggrieved party": Section 1-201. "Agreement": Section 1-201. "Cancel": Section 2B-602. "Contract": Section 1-201. "Copy": Section 2B-102. "Delivery": Section 2B-102. "Licensee". Section 2B-102. "Mass-market license": Section 2B-102. "Notifies": Section 1-201. "Party": Section 2B-102.

Official Comments:

1. *Scope and Effect.* This section deals with refusal of copies; it is a specific application of the general rule in Section 2B-601. The right to refuse tendered performance hinges either on the substantial nonconformity of the particular performance or on the existence of an uncured, prior material breach by the tendering party. The right to refuse a copy is subject to Sections 2B-610 and 2B-611.

2. *Conforming Tender Rule.* Subsection (b) implements the "conforming tender" rule for mass market transactions under standards consistent with Article 2. While often described as a "perfect tender" rule, this concept does not require the tender of a "perfect" copy or, under Article 2, a "perfect" product. It simply displaces the material breach standard with a requirement that the tender conform to the contract. In modern commerce, few contracts require perfection in an absolute sense. More often, under applicable trade use, general product descriptions, and concepts of merchantability, what is required is a tender that is consistent with ordinary expectations under the contract description.

3. *Effective Refusal.* Subsection (c) follows current Article 2 with respect to refusal of tender. Refusal is ineffective if the refusing party does not timely notify the other party of its refusal.

2B-610. INSTALLMENT CONRACTS; REFUSAL AND DEFAULT.

(a) In this section, "installment contract" means a contract in which the terms require or authorize delivery of copies of the same information in lots to be separately accepted, even if the contract contains a clause "each delivery is a separate contract" or its equivalent.

(b) In an installment contract, the party receiving tender may refuse any installment which is non-conforming if the non-conformity is a material breach as to that installment and cannot be cured or if the non-conformity is a material defect in any required documents. However, if the non-conformity is not within subsection (c) and the tendering party gives adequate assurance of its cure, the aggrieved party must accept that installment and may not cancel the whole contract if the tendering party timely completes the cure.

(c) If a non-conformity or default with respect to one or more installments is material as to the entire contract, there is a breach as to the entire contract. However, the aggrieved party reinstates the contract if it accepts a non-conforming installment without seasonably notifying the party in breach of contract of cancellation or if the aggrieved party brings an action with respect only to past installments or demands performance as to future installments.

Definitional Cross Reference:

"Aggrieved party": Section 1-201. "Cancellation": Section 2B-102. "Contract": Section 1-201. "Delivery": Section 2B-102. "Information": Section 2B-102. "Notify": Section 1-201. "Party": Section 2B-102. "Term". Section 1-201.

Official Comments:

This Section derives from current Section 2-612 and Article 2A.

2B-611. CONTRACTS WITH A PREVIOUS VESTED GRANT OF RIGHTS. If an agreement creates rights in or permissions to use informational rights which precede or are otherwise independent of the delivery of a copy, the following rules apply:

(1) A party may refuse a tender of a copy which is a material breach as to that copy, but refusing the copy does not cancel the contract.

(2) In a case governed by paragraph (1), the tendering party may cure by providing a conforming copy within a commercially reasonable time after the tender was refused and before the breach becomes material as to the entire contract.

(3) A breach that is material with respect to a copy allows cancellation of the contract only if there is a material breach of the entire contract which cannot be or is not seasonably cured.

Definitional Cross Reference:

"Agreement": Section 1-201. "Cancel": Section 2B-102. "Contract": Section 1-201. "Copy": Section 2B-102. "Delivery": Section 2B-102. "Informational Rights": Section 2B-102. "Party": Section 2B-102. "Rights": Section 1-201.

Notes:

1. *Scope and Purpose.* This Section deals with an important contractual relationship in information industries that resembles, but differs from "installment" contracts in Article 2. The similarity lies in that more than one performance occurs. The difference is that the performances involve a grant of rights followed by delivery of a copy, while installment contracts deal with sequential deliveries of copies.

The section distinguishes between (1) agreements where a grant to use informational rights vests independent of any copy, and (2) agreements where the purpose is to obtain rights associated with a copyThe Section describes the relationship between a tender of a copy in the former situations and cancellation of the entire contract or cure of the tender. Consistent with Section 2B-601, it indicates that refusal of the copy does not necessarily permit cancellation of the contract. This is because the grant of rights (already vested) is an independent, performed part of the agreement and the copy may be non-material.

If the refused copy does not materially breach the entire contract, the tendering party has a right to cure the defective tender by acting in a commercially reasonable time. That right is cut off only if tender and a failed or delayed cure constitute a material breach of the whole agreement.

2. *Nature of the Transaction.* The section applies only if the grant to use informational rights vests without receipt of a copy. Whether or when this circumstance exists depends on the agreement. It is, however, a routine transaction in information industries, especially distribution relationships and performance rights. In cases where this form of transaction exists, the parties view a copy as a mere conduit to complete an already vested conveyance. In such cases, a material defect in the copy is not **necessarily** material to the entire contract.

In contrast to cases under this section, if the agreement does not create a prior vesting of intellectual property use rights and the transaction is not an installment contract, a material defect in the copy is more often material to the entire transaction. This may benefit or disadvantage either party depending on the circumstances. Thus, if the contract is for rights associated with a copy, the licensee that refuses the copy is left solely with an action for damages; refusal in essence cancels the contract. If the intellectual property rights vested by agreement independent of a copy, the licensee can refuse the copy and still (1) expect and insist on performance and (2) exercise rights under the non-cancelled contract.

Illustration 1. IBM grants XYZ the right to distribute up to twenty thousand copies of its Fast-Pace Internet software in the United States over a one year period. Several weeks after the contract becomes enforceable, IBM delivers a master disk of the software for XYZ to use in producing copies for distribution. The master disk contains a manufacturing flaw. On learning of the defect, IBM replaces the disk. The contract is within this section. ABC can refuse the copy if the defect was material as to the copy, but cannot cancel the entire contract unless the defect and the delay was material to the entire contract. Even if it was not, XYZ can still recover damages for the delay, if any.

Illustration 2. Houston orders a 100 person site license from Micro for its operating system software. Micro ships a copy of the software, but the copy is warped and defective and arrives several weeks late. This contract does not come within this Section because there was no vested right to use informational rights independent of rights associated with the copy to be delivered. The issue is solely whether the tender was a material breach as to the copy.

Illustration 3. Warn grants Theo an exclusive license in Chicago to show the movie "Bond" during June, 1999, also giving Theo the right to display clips from the movie for advertising purposes. A copy of the movie is to be delivered one week before the first showing. Warn delivers several days late and the copy is technically defective and cannot be used. Theo refuses the copy. The contract falls in this Section because the grant of rights is independent of the copy. Refusal is not cancellation of the contract. Theo can continue to advertise using clips. Warn can cure in a reasonable time unless it delays to the point that it creates a material breach of the entire contract.

2B-612. DUTIES UPON RIGHTFUL REFUSAL OF A COPY.

(a) Upon a rightful refusal of a copy if a contract is rightfully canceled by the party refusing the copy, Section 2B-702 applies, but if the contract is not canceled, the parties remain bound by all contractual obligations.

(b) If a copy is rightfully refused, Tthe following rules apply with respect to that any copy and any copies made from that copy that was rightfully refused and is are within the possession or control of the party refusing the copy, except that if the contract was rightfully canceled, these rules apply only to the extent not inconsistent with Section 2B-702:

(1) Any use of the refused copy, the information it contains, any sale or other transfer of the copy, or any failure to comply with a contractual use restriction by the aggrieved party that refused the copy is a breach of contract unless authorized by this Section or by the tendering party. However, use of the copy or the information by the aggrieved party for a limited time within contractual use restrictions and solely to mitigate loss after the tendering party is notified of refusal is not a breach and does not constitute acceptance if the use is not contrary to instructions received from the party in breach concerning disposition of the copy.

(2) An aggrieved party in possession or control of a refused copy or any copies made from it shall deliver all copies, access or other material, and documentation pertaining to the refused copy to the tendering party or hold them with reasonable care for a reasonable time for disposal at that party's instructions.

(3) An aggrieved party shall follow any reasonable instructions received from the tendering party for delivery of the copies, material and documentation. Instructions are not reasonable if the tendering party does not arrange for payment of or reimbursement for reasonable expenses of complying with the instructions.

(4) If the tendering party does not give instructions within a reasonable time after being notified of refusal, the aggrieved party may, in a reasonable manner to avoid or mitigate loss, store the copies, material and documentation for the tendering party's account or ship them to the tendering party with a right of reimbursement for reasonable costs of storage and shipment.

(5) An aggrieved party in possession or control of a refused copy has no obligations under the contract other than those stated in this section with respect to the copy, material and documentation that were refused. However, except as otherwise provided in this section, both parties remain bound by any contractual use restrictions that would have been enforceable had the performance not been refused.

(6) In complying with this section, an aggrieved party in possession or control of a refused copy shall act in good faith and with care that is reasonable in the circumstances. Reasonable conduct in good faith under this section is not acceptance or conversion and is not the basis for an action for damages under the contract.

(7) These rules apply equally to the refused copy and copies made from it.

Uniform Law Source: Section 2-602(2), 2-603, 2-604.

Definitional Cross Reference:

"Access material": Section 2B-607. "Aggrieved party": Section 1-201. "Agreement": Section 1-201. "Cancel": Section 2B-102. "Contract": Section 1-201. "Contractual use restriction": Section 2B-102. "Copy": Section 2B-102. "Delivery": Section 2B-102. "Good faith": Section 2B-102. "Information": Section 2B-102. "Notify": Section 1-201. "Party": Section 2B-102. "Rights": Section 1-201.

Official Comments:

1. *Cancellation and Refusal.* The primary rule is that a refusal of a copy may or may not lead to a cancellation of the entire contract. When it does result in cancellation, the rules of Section 2B-702 apply. If the contract is not cancelled, this section applies and the parties remain bound by all contractual obligations, except of course, as altered by the breach itself and the remedies this made available.

2. *No Right to Use.* Subsection (1) limits the refusing party's right to use the information in its possession. In general, a refusing party has no right to continue to use the refused copies. Uses inconsistent with the terms of this section or the contract constitute a breach by the party engaging in the misuse.

The section does permit, however, limited uses for purposes of mitigating loss. That use does not extend to disclosure of confidential information, violation of a use restriction, or sale of the copies. It cannot be inconsistent with the refusal. This section asks courts to reach the balance discussed in Can-**Key Industries v. Industrial Leasing Corp.,** 593 P.2d 1125 (Or. 1979) and **Harrington v. Holiday Rambler Corp.,** 575 P.2d 578 (Mont. 1978) with respect to goods, but with an understanding of the nature of any intellectual property rights that may be involved.

3. *Handling Copies.* This section does not give the refusing party a right to sell goods, documentation or copies under any circumstance. The materials may be confidential and may be subject to the overriding influence of the proprietary rights held and retained by the other party. As Comment 2 to current ? 2-603 states: "The buyer's duty to resell under [that] section arises from commercial necessity...." That necessity is not present in information. The tendering party's interests are focused on protection of confidentiality or control, not on optimal disposition of the goods that may contain a copy of the information.

4. *Confidentiality.* Subsection (5) makes clear that, following refusal or revocation, both parties remain bound by contractual use restrictions, including confidentiality obligations with respect to the information. Unlike in reference to sales of goods, it is not uncommon that each party have some such information of the other and a mutual, continuing restriction is appropriate to the extent allowed by applicable trade secret or other law. The contractual use restrictions, of course, relate only to the information acquired under and subject to the license. In most cases, this does not restrict the party's ability to obtain the same information from alternative sources independent of the contract restrictions.

2B-613. ACCEPTANCE OF COPY; EFFECT.

(a) Acceptance of a copy occurs when the party to which the copy is tendered:

(1) signifies, or acts with respect to the copy in a manner that signifies, that the performance was conforming or that the party will take or retain the performance in spite of a nonconformity;

(2) fails to make an effective refusal;

(3) commingles the copy or the information in a manner that makes compliance with the party's duties after refusal impossible;

(4) substantially obtains the benefit or access from the copy and cannot return that benefit or access; or

(5) acts in a manner inconsistent with the licensor's ownership, but if such act is wrongful against the licensor it is a acceptance only if ratified.

(b) Except in cases governed by subsection (a)(3) or (4), if there is a right to inspect under Section 2B-608 or the agreement, acceptance of a copy occurs only after the party has had a reasonable opportunity to inspect.

(c) If an agreement requires delivery in stages involving separate portions of the information which taken together comprise the whole of the information, acceptance of any stage is conditional until acceptance of the whole.

(d) Acceptance of a copy precludes refusal and, if made with knowledge of the nonconformity, may not be revoked because of a nonconformity in the copy unless acceptance was on the reasonable assumption that the nonconformity would be seasonably cured. However, acceptance does not in itself impair any other remedy for nonconformity.

Uniform Law Source: Section 2-607(2); Section 2A-515. Revised.

Definitional Cross Reference:

"Agreement": Section 1-201. "Cancel": Section 2B-102. "Contract": Section 1-201. "Copy": Section 2B-102. "Delivery": Section 2B-102. "Party": Section 2B-102. "Remedy": Section 1-201. "Rights": Section 1-201.

Official Comments:

1. Acceptance is the opposite of refusal.

2. Subsections (a)(1) and (2) conform to Article 2A, clarifying that actions as well as communications can signify acceptance.

3. Subsection (a)(3) and (4) focus on two circumstances significant in reference to information and that raises issues different from cases involving goods. In (a)(3), the key fact is that it would be inequitable or impossible to reject the data or information having commingled the material. The receiving party can exercise rights in the event of breach, but refusal is not a helpful paradigm. A refusing party must return or keep available the information for return. Commingling does not refer only to blending the information into a common mass in which it is indistinguishable; it also includes software integrated into a complex system in a way that renders removal and return impossible or information integrated into a database or knowledge base from which it cannot be separated.

4. Subsection (a)(4) involves use or exploitation of the value of the material by the licensee. In information transactions, in many instances merely being exposed to the factual or other material transfers the significant value. Often, use of the information does the same. Again, rejection is not a useful paradigm. The recipient can sue for damages for breach and, when breach is material, either collect back its paid up price or avoid paying a price that would otherwise be due.

2B-614. REVOCATION OF ACCEPTANCE OF COPY.

(a) A party that has accepted a copy may revoke acceptance of the copy due to a nonconformity if the nonconformity is a material breach as to that copy and the party accepted the performance:

(1) on the reasonable assumption that the nonconformity would be cured, and it has not been seasonably cured;

(2) during a period of continuing efforts by the party in breach at adjustment and cure, and the breach has not been seasonably cured; or

(3) without discovery of the nonconformity, if the acceptance was reasonably induced either by the other party's assurances or by the difficulty of discovery before acceptance.

(b) Revocation is not effective until the revoking party notifies the other party of the revocation.

(c) Revocation of acceptance is barred if:

(1) it does not occur within a reasonable time after the licensee discovers or should have discovered the ground for it;

(2) it occurs after a substantial change in condition or identifiability not caused by defects in the information; or

(3) the party attempting to revoke received a substantial benefit from the information which benefit cannot be returned.

(e) A party that rightfully revokes acceptance of a copy has the same duties and is under the same restrictions if the party had refused a copy.

Uniform Law Source: Section 2A-516; 2-608**.** Revised.

Definitional Cross Reference:

"Copy": Section 2B-102. "Information": Section 2B-102. "Informational Rights": Section 2B-102. "Licensee". Section 2B-102. "Notifies: Section 1-201. "Party": Section 2B-102. "Rights": Section 1-201.

Official Comments:

1. Acceptance obligates the licensee to the terms of the contract, including the payment of any purchase price. This section deals with revocation of acceptance as to any type of performance, not limited to the revoked acceptance of a tender of delivery that occupies the attention of article 2.

2. Subsection (a)(2) adds provisions to deal with an issue often encountered in litigation in software. In cases of continuing efforts to modify and adjust the intangibles to fit the licensee's needs, asking when an acceptance occurred raises unnecessary factual disputes. Both parties know that problems exist and this Section would allow revocation if the effort fails and the other conditions barring revocation do not arise.

3. Revocation is a remedy for the licensee, but its role in the remedies scheme must be carefully understood. In effect, revocation reverses the effect of acceptance and places the licensee in a position like that of a party who rejected the transfer initially. The effects of acceptance that are most important here include: (i) the licensee must pay the licensee fee for the transfer and is obligated as to other contract duties respecting that transfer and (ii) the licensee essentially keeps the copies or other materials associated with the transfer but subject to contract terms. Revocation is not a precondition to suing for damages.

[C. Special Types of Contracts]

2B-615. ACCESS CONTRACTS.

(a) If an access contract provides for access over a period of time, during that period of time the licensee's rights of access are to the information as modified from time to time and made commercially available by the licensor. In addition, the following rules apply:

(1) A change in the content of the information is a breach of contract only if it conflicts with an express term of the agreement.

(2) Unless subject to a contractual use restriction in the access contract or in another license pertaining to the information, information obtained by the licensee is free of any use restriction other than restrictions resulting from the informational rights of any person or from other applicable law.

(3) Access must be available at times and in a manner:

(A) conforming to the express terms of the contract; and

(B) to the extent not expressly dealt with by the contract, in a manner and with a quality that is reasonable in light of the ordinary standards of the business, trade, or industry for the particular type of contract.

(b) In an access contract that gives the licensee a right of access at times substantially of its own choosing during agreed periods of time, an intermittent and occasional failure to have access available during those times is not a breach of contract if it is consistent with:

(1) consistent with the express terms of the contract;

(2) consistent with ordinary standards of the business, trade, or industry for the particular type of contract; or

(3) caused by scheduled downtime, reasonable needs for maintenance, reasonable periods of equipment, software, or communications failure, or events reasonably beyond the licensor's control.

Definitional Cross Reference:

"Access contract": Section 2B-102. "Agreement": Section 1-201. "Contract": Section 1-201. "Contractual use restriction": Section 2B-102. "Information": Section 2B-102. "Informational Rights": Section 2B-102. "License": Section 2B-102. "Licensee". Section 2B-102. "Licensor": Section 2B-102. "Person": Section 2B-102. "Rights": Section 1-201. "Software". Section 2B-102. "Term". Section 1-201.

Official Comments:

1. *Nature of an Access Contract.* Access contracts come in two types. In one, access and the contract occur at the same time and there is no on-going relationship between the parties. In the other, a continuous access contract, the licensee has a right to intermittent access at times of its own choosing within the time period of agreed availability. This relationship is illustrated by on-line services such as Westlaw and Lexis. The transaction is not only that the transferee receives the functionality or the information, but that the subject matter be accessible on a continuing basis. A continuous access contract is unlike installment contracts under Article 2 which are segmented into tender-acceptance

sequences. Often, the licensor here merely keeps the system on-line and available for the licensee to access when it chooses.

Access contracts are licenses in the pure common law sense that they grant a right to have use of a facility or resource controlled by the licensor. This involves less of intellectual property license and more of a modern application by analogy of traditional concepts of licensed use of physical resources.

2. *Basic Obligation.* The obligation in a continuous access contract is to make and keep the system available in a reasonable manner consistent with contract terms. As indicated in subsection (a)(3), availability standards are subject to contractual specification, but in the absence of contract terms, the appropriate reference is to general standards of the industry involving the particular type of transaction. Thus, a contract involving access to a news and information service would have different accessibility expectations than would a contract to provide remote access to systems for processing air traffic control data. See *Reuters Ltd. v. UPI, Inc.*, 903 F.2d 904 (2d Cir. 1990); *Kaplan v. Cablevision of Pa., Inc.*, 448 Pa. Super. 306, 671 A.2d 716 (Pa. Super. 1996).

3. *Content Changes.* The access arrangement does not bind the provider of access to making available information unless the express contract terms require this. This is a significant default rule in reference to multi-element commercial databases provided to licensees by electronic access which involve constantly changes in the content and mixture of information made available..

4. *Use of Received Information.* Subsection (a)(2) deals with use restrictions. Unless there are terms dealing with restrictions on use of the information obtained through access, information thus obtained is received on an unrestricted basis, subject only to intellectual property rights. For example, if an access contract merely enables access to news articles, but does not limit their use by the licensee, no limitation exists other than under copyright law. In contrast, if the agreement contains license restrictions on use of the articles , those terms would be governed under Article 2B.

2B-616. CORRECTION AND SUPPORT CONTRACTS.

(a) If a person agrees to correct performance problems or provide similar services with respect to information other than as an effort to cure its own breach of contract, the following rules apply:

(1) Except as otherwise provided in paragraph (2), the person:

(A) shall perform at a time and place and with a quality consistent with the express terms of the agreement and, to the extent not dealt with by the express terms, in a manner that is reasonable in light of ordinary standards of the business, trade, or industry; and

(B) does not commit that its services will correct all performance problems unless the agreement expressly so provides.

(2) If the services are provided by a licensor of the information to which the services relate and are part of a limited contractual remedy in a license or software contract for that information, the licensor undertakes that its performance will provide the licensee with information that conforms to the agreement.

(b) A licensor is not required to provide instruction or other support for the licensee's use of information or access. A person that agrees to provide support shall make the support available in a manner and with a quality consistent with the express terms of the support agreement and, to the extent not dealt with by the agreement, in a manner that is reasonable in light of ordinary standards of the business, trade or industry.

Uniform Law Source: Restatement (Second) of Torts § 299A.

Definitional Cross Reference:

"Agreement": Section 1-201. "Contract": Section 1-201. "Information": Section 2B-102. "Licensee". Section 2B-102. "Licensor": Section 2B-102. "Person": Section 2B-102. "Remedy": Section 1-201. "Term". Section 1-201.

Official Comments:

1. *Nature of the Obligation.* The section deals with obligations to correct performance problems and to provide support. It does not deal with questions about infringement or third party rights claims. Obligations to correct performance problems are different from an obligation to provide updates or enhanced versions. In modern practice, contracts to provide updates are a source of revenue for software providers. Under Section 2B-310, no implied obligation exists to provide updates or new versions.

The reference to error corrections covers contracts where, for example, a vendor agrees to be available to come on site and correct or attempt to correct bugs in the software for a fee. This is a services

contract. The other type of agreement occurs when, for example, a vendor contracts to make available to the licensee new versions of the software developed for general distribution. Often, the new versions cure problems that earlier versions encountered and the two categories of contract overlap. Yet, here we are dealing with new products .

3. *Services Obligation.* Contracts to correct problems are services contracts. The primary obligation is in subsection (a)(2). The obligation is the obligation that any services provider would undertake: a duty to act consistent with the standards of the business to complete the task. A services provider does not guaranty that its services yield a perfect result. The standard measures a party's performance by reference to standards of the relevant trade or industry.

4. *Services in Lieu of Warranty.* Subsection (a)(1) recognizes an important alternative formulation of the provider's obligations. It deals with situations in which the circumstances indicate that promissor agrees to a particular outcome. The obligation arises if the repair obligation is part of a limited remedy in lieu of a warranty. The prototype is the "replace or repair" warranty. When the obligation to correct errors arises in that context, the obligation is to complete a product that conforms to the contract.

5. *Support Agreements.* Subsection (b) provides a default rule regarding support agreements. As another form of services contract, the appropriate standard is an obligation consistent with reasonable standards of the industry.

2B-617. CONTRACTS INVOLVING PUBLISHERS, DISTRIBUTORS, AND END USERS.

(a) In this section:

(1) "Distributor" means a merchant licensee that receives information directly or indirectly from a licensor for the purpose of selling or licensing the information to end users.

(2) "End user" means a licensee that acquires a copy of the information from a distributor by delivery on a physical medium for its own use and not for distribution or transmission to third parties or public display or performance for a fee.

(3) "Publisher" means a licensor, other than a distributor, that offers a license to an end user with respect to information distributed to the end user by a distributor.

(b) In a contract between a distributor and an end user, if the end user's right to use the information or informational rights is subject to a license from the publisher and there was no opportunity to review the license before the end user became obligated to pay the distributor, the following rules apply:

(1) The contract between the end user and the distributor is conditional on the end user's agreement to the publisher's license.

(2) If the end user does not agree, by manifesting assent or otherwise, to the terms of the publisher's license, the end user has a right to a refund on return of the information to the distributor. A right to a refund under this paragraph is a refund for Sections 2B-112 and 2B-208.

(3) The distributor is not bound by the terms of, and does not receive the benefits of, an agreement between the publisher and the end user unless the distributor and end user adopt those terms as part of their agreement.

(c) If an agreement provides for distribution of copies on a physical medium provided by the publisher, a distributor shall distribute the copies and documentation received from the publisher or authorized third party:

(1) in the form as received; and

(2) subject to any contractual terms of the publisher provided for end users.

(d) A distributor that enters into a license or software contract with an end user is a licensor of the end user for all purposes under this article, including warranties, other performance obligations, and remedies.

Definitional Cross References. "Agreement": Section 1-201. "Contract": Section 1-201. "Copy": Section 2B-102. "Delivery": Section 2B-102. "Information": Section 2B-102. "License": Section 2B-102. "Licensee". Section 2B-102. "Licensor": Section 2B-102. "Merchant": Section 2B-102. "Party": Section 2B-102. "Receive": Section 2B-102. "Refund": Section 2B-102. "Rights": Section 1-201. "Term". Section 1-201.

Official Comments:

1. *Scope and Context: Three Party Relationship.* This section deals with a three party relationship common in information transactions. The transaction involves a publisher, distributor, and end user.

While the end user acquires the copy of information from a distributor, whether the distributor has authority to convey a right to use the work or the right to transfer title to the copy is determined by its contract with the publisher. That contract often permits conveyance only under specified conditions. In such cases, the end user's right to "use" (e.g., copy) arises by a separate agreement between the end user and the publisher. Often, in retail markets, this latter agreement is an on-screen license or a shrink wrap license.

2. *Distributor and End User.* While there are three parties and three separate relationships, the relationships are linked. Subsection (b) deals with that relationship from the perspective of the distributor's contract with the end user.

a. Contracts are Separable. The basic principle is that a distributor is not bound by nor does it benefit from any contract created by the publisher with the end user. This mirrors case law where manufacturer warranties and warranty limitations do not bind the distributor, but also do not benefit that distributor. The distributor does not have the benefit of warranty disclaimers in a publisher's license. That can be changed by contract, but as a defaultr rule gives the end user two different points of recourse - distributor and publisher.

b. Distributor is a Licensor. Subsection (d) confirms that warranties exist on the part of the distributor by stating that the distributor is a licensor with respect to its licensee.

c. Conditional Rights. Under subsection (b)(1) and (b)(2) performance of the distributor's relationship with the end user hinges on the end user's ability to make actual use of the information supplied by the distributor and that this depends on the license between the publisher and the end user. This gives the end user who declines a license a right to a refund or to cancel payment to the distributor. This creates a refund *right*, rather than an option. It reflects the conditional nature of the transaction with the end user.

There are several ways to view the relationship. One treats the publisher's license as part of the distributor's contract, understood as present by both the distributor and the end user from the outset, even if the precise terms are not yet known. See *ProCD v. Zeidenberg,* 86 F.3d 1447 (7th Cir. 1996). An alternative treats the distributor's commitment as being to deliver the copy and to convey the right to use (e.g., copy into a machine). It cannot do the latter until the end user assents to the publisher's license if, as in most cases, the distributor's contract with the publisher authorizes only distributions subject to end user licenses. The end user's assent to the publisher's license is then, as to the distributor, either a condition precedent (no final agreement until the end user assents to or rejects the license) or a condition subsequent (agreement subject to rescission if the license is unacceptable). In either case, if the end user declines the license, it can timely return the product to the distributor and obtain a refund or, if it has not already paid, avoid being forced to pay the contract fee.

Subsection (b)(1) and (b)(2) create this latter result. See *Beta Computer (Europe) Ltd. v. Adobe Systems (Europe) Ltd.* The contract between the distributor and end user is a license in that the end user's use rights are subject to assent to and the terms of the publisher's license. When the end user assents to the license, the publisher's license in effect replaces the distributor-end user contract except as to obligations expressly created and earmarked as continuing on the part of the distributor (such as a services or support obligation). Of course, if the information breaches a warranty, the right to recover from the distributor remains present unless it was disclaimed by the distributor's contract.

Illustration 1: User acquires three programs from Distributor for $1,000 each. User is aware that each software program comes subject to a publisher license. When it reviews one license, it notices that the license restricts use to non-commercial purposes. User refuses that license. It has a right to refund since the distributor's contract is conditioned on the user's consent to the publisher's license.

3. *Distributor and Publisher.* In most cases if an end user license is intended, the publisher's arrangement with the distributor is a license that retain ownership of copies in the publisher and permits distribution only subject to an end user license. The legislative history of the Copyright Act indicates that, whether there was a sale of the copy or not, contractual restrictions on use are appropriate under contract law.

"[The] outright sale of an authorized copy of a book frees it from any *copyright* control over ... its future disposition.... This does not mean that conditions ... imposed by contract between the buyer and seller would be unenforceable between the parties as a breach of contract, but it does mean that they could not be enforced by an action for infringement of copyright." H.R. Rep. No. 1476, 94th Cong., 2d Sess. 79 (1976).

2B-618. DEVELOPMENT CONTRACTS.

(a) In this section:

(1) "Client" means a person that hires a developer.

(2) "Developer" means a person, other than an employee of a client, hired or commissioned to create or develop software for the client other than an employee of a client.

(b) On request of a client in a record received by a developer, the developer shall notify the client as to whether the developer used independent contractors or information provided by third parties and shall provide the client with a statement that either confirms that all applicable informational rights have been obtained or will be obtained or that it makes no representation about those rights beyond any stated in the agreement. The notice and the statement must be made within 30 days after the request is received unless the time for performance of the development contract is less than 30 days, in which case the notice and the statement must be given before completion of performance.

Definitional Cross References:

"Agreement": Section 1-201. "Contract": Section 1-201. "Information": Section 2B-102. "Informational Rights": Section 2B-102. "Notify": Section 1-201. "Person": Section 2B-102. "Record": Section 2B-102. "Rights": Section 1-201. "Software". Section 2B-102. "Term". Section 1-201.

Official Comments:

The Section provides important protection for a licensee not found in current law. The section reacts to a problem created under federal intellectual property law, especially as to copyright ownership. Copyright law allows independent contractors to retain copyright control of their work unless they expressly transfer it. The licensee, even if unaware of the contractor's rights, is subject to them since intellectual property law does not contemplate good faith buyer protection. The section places an obligation on the developer of software to respond to a request of the licensee. This does not supplant warranties against infringement or warranties of title, but sets out a method to avoid those problems.

2B-619. CONTRACTS BETWEEN FINANCIERS AND LICENSEES.

(a) If a financier of a licensee does not become a licensee, the following rules apply:

(1) The financier does not receive the benefits or burdens of the license.

(2) The licensee's rights and obligations with respect to the information and informational rights are governed by:

(A) not altered with respect to the licensor and the terms of the license; the license and, in the absence of terms, the provisions of this article regarding rights with respect to the license;

(B) any rights of the licensor under other applicable law; and

(BC) to the extent not inconsistent with subparagraph (A) and (B), governed by the agreement between the licensee and the financier.

(b) If a financier of a licensee becomes a licensee and transfers the license to a licensee receiving the financial accommodation, the following rules apply:

(1) A transfer to the accommodated licensee is not effective unless:

(A) the transfer is effective under Sections 2B-502 and 2B-503; or

(B) the following conditions are met:

(i) before the licensor delivered the information or granted the license, the licensor received notice from the financier giving the name and location of the accommodated licensee and clearly indicating that the license is being obtained in order to transfer it to the accommodated licensee;

(ii) the financier became a licensee solely to make the financial accommodation; and

(iii) the accommodated licensee adopts the terms of the license.

(2) A financier that makes a transfer effective under paragraph (1)(B) may make only the single transfer contemplated by the notice unless the licensor consents to a subsequent transfer.

(c)If a financier makes an effective transfer of a license to an accommodated licensee, the

following rules apply:

(1) The accommodated licensee becomes a party to the original license and its rights and obligations are governed by:

(A) the license and, in the absence of terms, the provisions of this article regarding rights with respect to the license;

(B) any rights of the licensor under other applicable law; and

(C) to the extent not inconsistent with subparagraphs (A) and (B), the agreement between the financier and the licensee.

(2) The financier makes no warranties to the accommodated licensee other than the warranty of quiet enjoyment under Section 2B-401(b) and any express warranties in the agreement between the financier and the licensee.

(d) Unless the accommodated licensee is a consumer, a term in the agreement between the financier and the licensee that the accommodated licensee's obligations under that agreement are irrevocable and independent of the license is enforceable. The obligations become irrevocable and independent upon:

(1) the licensee's adoption of the terms of the license or payment by the financier to the licensor, unless:

(A) the information or informational right was selected, created, or supplied by the financier;

(B) the financier provides support, modifications, or maintenance for the information; or

(C) the financier holds informational rights in the information; or

(2) the licensee's adoption of the terms of the license and the transfer to a third party of the contract between the licensee and the financier.

(e) As between the financier and the accommodated licensee, the parties may agree which of them is entitled to the possession of any copies, improvements, or modifications of the information provided by the licensor, but the effect of such an agreement on the licensor is determined by Section 2B-503.

(f) On material breach by the accommodated licensee of the agreement between the financier and the licensee, the financier may:

(1) cancel its contract with the accommodated licensee but may not cancel the license; and

(2) subject to Sections 2B-502 and 2B-503, exercise its remedies against the accommodated licensee its remedies under the contract or this article.

Definitional Cross References.

"Agreement": Section 1-201. "Cancel": Section 2B-102. "Consumer": Section 2B-102. "Contract": Section 1-201. "Financier". Section 2B-102. "Information": Section 2B-102. "Informational Rights": Section 2B-102. "License": Section 2B-102. "Licensee". Section 2B-102. "Licensor": Section 2B-102. "Notice": Section 1-201. "Party": Section 2B-102. "Receive": Section 2B-102. "Rights": Section 1-201. "Transfer". Section 2B-102. "Term". Section 1-201.

Official Comments:

1. *Scope.* This section integrates treatment of security interests and finance leases. It deals with the rights among the parties. The critical distinction is between a traditional loan arrangement where the financier does not become a party to the license and the relationship that exists more in three party leases where the lessor (financier) acquires the property (license) and transfers it to the licensee.

The financial accommodation is conditional on the licensee's assent to the license. In the absence of such assent, the licensee may have no rights to use the information and, thus, the transaction is illusory from its standpoint. This transaction is different from the ordinary equipment lease because of the importance of this license agreement and the provisions here recognize that importance. (see also the treatment of when promises become irrevocable).

2. *Licensor and Licensee Direct Contracts.* Subsection (a) involves a situation where the licensor contracts directly with the licensee as to the information, even though the lessor may also have a contract with the licensee. The financier is bound by the limitations of the license. The licensee's rights are governed first by the license and secondly by the financial accommodation agreement.

3. *Financier as a Transferor.* Subsection (b) deals with the less common situation where the license is actually provided to the financier and then passed through to the licensee. Here, when the eventual licensee takes on the license, the financier is taken out of the transaction as between the licensee and financier for purposes of qualitative performance issues. The licensee becomes a direct party to the license.

4. *Hell and High Water Clauses.* Subsection (e) provides rules pertaining to hell and high water clauses. Promises become irrevocable if the agreement so provides and the financier was not an active,

substantive party to the license. The rule is not needed where the financier never acquires a position as licensor/ licensee, but is helpful in the three party context.

The irrevocability concept as between the two parties is limited here not only to acceptance of the transfer, but also payment to the licensor. Subsection (e)(2) refers to the common situation where the contract allows irrevocability when it is transferred to a third party.

5. *Right to New Versions.* Subsection (f) deals with an area of litigation in the leasing industry, focusing on the relationship between the three parties in reference to update and the like made available during the license term. As between the financier and its debtor, possession and rights of control can be apportioned by the financing agreement. As to the licensor, however, Section 2B-503 controls.

6. *Remedy.* Subsection (g) states a primary right of the financier in the event of breach. Since the financier is not a party to the license, it cannot cancel that contract.

[D. Performance Problems]

2B-620. RIGHT TO ADEQUATE ASSURANCE OF PERFORMANCE.

(a) A contract imposes an obligation on each party that the other's expectation of receiving due performance will not be impaired. If reasonable grounds for insecurity arise with respect to the performance of either party, the aggrieved party may demand in a record adequate assurance of due performance and, until the demanding party receives that assurance, may if commercially reasonable suspend any performance, other than with respect to contractual use restrictions, for which the party has not already received the agreed return.

(b) Between merchants, the reasonableness of grounds for insecurity and the adequacy of any assurance offered must be determined according to reasonable commercial standards.

(c) Acceptance of any improper delivery or payment does not prejudice an aggrieved party's right to demand adequate assurance of future performance.

(d) After receipt of a justified demand, failure to provide within a reasonable time not exceeding 30 days assurance of due performance that is adequate under the circumstances of the particular case is a repudiation of the contract.

Uniform Law Source: 2-609.

Definitional Cross References.

"Aggrieved party": Section 1-201. "Contract": Section 1-201. "Contractual use restriction": Section 2B-102. "Delivery": Section 2B-102. "Merchant": Section 2B-102. "Party": Section 2B-102. "Record": Section 2B-102. "Rights": Section 1-201.

Official Comments: Corresponds to existing Article 2.

2B-621. ANTICIPATORY REPUDIATION. If either party repudiates a contract with respect to a performance not yet due the loss of which will substantially impair the value of the contract to the other, the aggrieved party may:

(1) for a commercially reasonable time await performance by the repudiating party; or

(2) resort to any remedy for breach of contract, even if it has notified the repudiating party that it would await the latter's performance and has urged retraction; and

(3) in either case, suspend its own performance or proceed in accordance with Sections 2B-712 or 2B-713, as applicable. **Uniform**

Law Source: 2-610. **Definitional**

Cross References.

"Aggrieved party": Section 1-201. "Contract": Section 1-201. "Notify": Section 1-201. "Party": Section 2B-102. "Remedy": Section 1-201. "Value": Section 1-201.

Official Comments: Corresponds to Article 2..

2B-622. RETRACTION OF ANTICIPATORY REPUDIATION.

(a) Until a repudiating party's next performance is due, it may retract its repudiation unless the aggrieved party has since the repudiation canceled or materially changed its position in reliance on the repudiation or otherwise indicated that it considers the repudiation final.

(b) Retraction may be by any method that clearly indicates to the aggrieved party that the repudiating party intends to perform, but must include any assurance justifiably demanded under Section 2B-620.

(c) Retraction reinstates a repudiating party's rights under the contract with due excuse and allowance to the aggrieved party for any delay occasioned by the repudiation.

Uniform Law Source: Section 2-611.

Definitional Cross References.

"Aggrieved party": Section 1-201. "Cancel": Section 2B-102. "Contract": Section 1-201. "Party": Section 2B-102. "Rights": Section 1-201.

Official Comments: Corresponds to existing Article 2.

[E. Loss and Impossibility]

2B-623. RISK OF LOSS OF COPIES.

(a) Except as otherwise provided in this section, the risk of loss as to a copy passes to the licensee upon its receipt of the copy.

(b) If a contract requires or authorizes a licensor to send a copy on a physical medium by carrier, the following rules apply:

(1) If the contract does not require the licensor to deliver the copy at a particular destination, the risk of loss passes to the licensee when the copy is delivered to the carrier, even if the shipment is under reservation.

(2) If the contract requires the licensor to deliver the copy at a particular destination and the copy is duly tendered there in the possession of the carrier, the risk of loss passes to the licensee when the copy is tendered at that destination.

(3) If a tender of delivery of a copy or a shipping document fails to conform to the contract, the risk of loss remains with the licensor until cure or acceptance.

(c) If a copy is held by a third party to be delivered or reproduced without being moved, or a copy is to be delivered by making access available to a physical resource containing a tangible copy, the risk of loss passes to the licensee upon:

(1) the licensee's receipt of a negotiable document of title covering the copy;

(2) acknowledgment by the third party to the licensee of the licensee's right to possession of or access to the copy; or

(3) the licensee's receipt of a record directing the third party to make delivery or authorizing the third party to allow access.

(d) If a copy is to be delivered electronically, subsection (a) applies.

Uniform Law Source: Section 2-509. Revised.

Definitional Cross Reference:

"Contract": Section 1-201. "Copy": Section 2B-102. "Delivery": Section 2B-102. "Licensee". Section 2B-102. "Licensor": Section 2B-102. "Party": Section 2B-102. "Record": Section 2B-102. "Rights": Section 1-201. "Send". Section 2B-102.

Official Comments:

1. *Nature of the Issue.* Risk of loss issues relate to copies of the information and eventually deal with the obligation to pay for or provide additional copies or additional access to obtain new copies of the information. This section uses a concept of transfer of possession or control as the general standard for when risk of loss is transferred to the other party. Unlike in the sale of goods, however, the issue may go in either or both directions as there are many transactions in which licensees provide information to licensors.

Under subsection (a), in an access contract, risk remains with the access provider or licensor as to the information that it controls and retains, but passes to the licensee as to copies made by the licensee on the making of that copy.

2. *Transfer by Carrier.* The rules in subsection (b) correspond to Article 2.

2B-624. EXCUSE BY FAILURE OF PRESUPPOSED CONDITIONS.

(a) Except so far as a party may have assumed a greater obligation, delay in performance or nonperformance in whole or in part by a party other than an obligation to make payments is not a breach of contract if performance as agreed has been made impracticable by:

(1) the occurrence of a contingency whose nonoccurrence was a basic assumption on which the contract was made; or

(2) compliance in good faith with any applicable foreign or domestic governmental regulation or order, whether or not it later proves to be invalid.

(b) A party claiming excuse under subsection (a) shall seasonably notify the other party that there will be delay or nonperformance.

(c) If the claimed excuse affects only a part of the party's capacity to perform, the party claiming excuse shall allocate performance among its customers in any manner that is fair and reasonable and notify the other party of the estimated quota to be made available. The party claiming excuse may include the requirements of regular customers not then under contract and its own requirements in making the allocation.

(d) A party that receives notice in a record of a material or indefinite delay, or of an allocation that would be a material breach of the entire contract, may:

(1) terminate and thereby discharge any executory portion of the contract; or

(2) modify the contract by agreeing to take the available allocation in substitution.

(e) If, after receipt of notice under subsection (b), a party fails to modify the contract within a reasonable time not exceeding 30 days, the contract lapses with respect to any performance affected.

Uniform Law Source: Section 2A-405, 406; Section 2-615, 616.

Definitional Cross Reference:

"Contract": Section 1-201. "Good faith": Section 2B-102. "Notice": Section 1-201. "Notify": Section 1-201. "Party": Section 2B-102. "Receive": Section 2B-102. "Record": Section 2B-102.

This section states the ordinary UCC formulation of impossibility themes.

[F. Termination]

2B-625. TERMINATION; SURVIVAL OF OBLIGATIONS.

(a) Except as otherwise provided in subsection (b), on termination of a contract, all obligations that are still executory on both sides are discharged.

(b) The following survive termination of a contract:

(1) a right based on previous breach of contract or performance;

(2) a contractual use restriction with respect to any licensed copies or information received from the other party, or copies made from the information received, that are not returned to the other party;

(3) an obligation to return, deliver, or dispose of information, materials, documentation, copies, records, or the like to the other party or to obtain information from an escrow agent;

(4) a term establishing a choice of law or forum;

(5) an obligation to arbitrate or otherwise resolve disputes by alternative dispute resolution procedures;

(6) a term limiting the time for commencing an action or for providing notice;

(7) a term of indemnity;

(8) a limitation of remedy or disclaimer of warranty;

(9) an obligation to provide an accounting and make any payment due under the accounting; and

(10) any right, remedy, or obligation stated in the agreement as surviving to the extent enforceable under applicable law.

Uniform Law Source: Section 2A-505(2); Section 2-106(3).

Definitional Cross References.

"Agreement": Section 1-201. "Contract": Section 1-201. "Contractual use restriction": Section 2B-102. "Information": Section 2B-102. "Notice": Section 1-201. "Party": Section 2B-102. "Receive": Section 2B-102. "Record": Section 2B-102. "Remedy": Section 1-201. "Rights": Section 1-201. "Term". Section 1-201. "Termination". Section 2B-102.

Official Comments:

1. *Effect of Termination.* Subsection (a) states the effect of termination, which refers to the discharge of *executory* obligations. Termination does not end vested rights or remedies. This rule corresponds to current law and to commercial practice.

2. *Survival Rules.* Subsection (b) provides a list of provisions and rights that survive termination. In most of the cases, the list presumes that the obligation was created in the contract. The list indicates terms that would ordinarily survive in a commercial contract. The intent is to provide background support, reducing the need for specification in the contract with resulting risk of error.

Of course, additional surviving terms can be added and the terms provided here can be made to be non-surviving. To do so, however, the contract would require specific reference and negation.

2B-626. NOTICE OF TERMINATION.

(a) Except as otherwise provided in subsection (b), a party may not terminate a contract except on the happening of an agreed event, such as the expiration of the stated duration, unless the party gives reasonable notice of termination to the other party.

(b) An access contract may be terminated without notice unless the access contract pertains to information owned by the licensee and provided by it to the access contract licensor.

(c) A term dispensing with notification required under this section is invalid if its operation would be unconscionable. However, a term specifying standards for giving notice is enforceable if the standards are not manifestly unreasonable.

Uniform Law Source: Section 2-309(c)

Definitional Cross References.

"Access contract": Section 2B-102. "Contract": Section 1-201. "Information": Section 2B-102. "Licensee". Section 2B-102. "Licensor": Section 2B-102. "Notice": Section 1-201. "Party": Section 2B-102. "Term". Section 1-201. "Termination". Section 2B-102.

Official Comments:

1. *Termination in General.* Termination involves an end to the contract for reasons other than breach of the contract. The rules stated here do not apply to cancellation for breach

2. *Termination on the Happening of an Event.* For termination based on an agreed event (e.g., the end of the stated license term), no notice is required. This corresponds to current Article 2 and common law.

3. *Notice in Other Cases.* If termination occur based on a judgment of one party (such as an "at will termination") notice must be given of the termination. The notice must be reasonable. What is reasonable varies with the circumstances. Thus, for example, where the reason for termination involves criminal conduct or a desire to prevent harmful acts by the other party, notice at or immediately after termination may suffice. In other, less exigent circumstances, advance notice is needed. As indicated in subsection (c), the notice requirement may be waived or the terms and timing of notice specified by agreement.

This section requires "giving" notice. A requirement that notice be received would create uncertainty even though the party is merely exercising a contractual right. The uncertainty is especially great in online or Internet situations where the current or actual location of many users may be difficult or impossible to ascertain.

4. *Access Contracts.* Under subsection (b), termination of access contracts does not require notice. In these cases, the contractual rights granted to the licensee are to access a resource owned by the licensor. When the contract terminates, the access privilege also terminates. This is consistent with current law in licenses of this type. In fact, in many cases, unless the contract otherwise provides, a license to use resources or property of the licensor is subject to termination at will without notice.

This section provides a limited exception to the common law rule in cases where the access contract involves information provided to the licensor and owned by the licensee. What is meant here is ownership of the information, not of the other property to which the information may refer. Thus, for example, customer transactional information is typically not owned by the customer to whom it refers and the mere fact that customer data is included in the access material does not trigger the exception.

4. *Contract Modification.* This is from Article 2

2B-627. TERMINATION ENFORCEMENT.

(a) On termination of a license, a party in possession or control of information, documentation, copies, or other materials that are the property of the other party or are subject to a contractual obligation to be delivered to that party on termination of the license shall use commercially reasonable efforts to deliver the materials or hold them for disposal on instructions of the party to

which they are to be delivered. If any materials are jointly owned, the party in possession or control shall make the jointly owned materials available to the other joint owner.

(b) Termination of a license ends any contractual right to use or access the information, informational rights, or copies. Unless authorized by the agreementagreement, continued exercise of the terminated rights or other use of the information is a breach of contract.

(c) Each party is entitled to enforce its rights under subsections (a) and (b) by judicial process, including an order that the party or an officer of the court:

(1) deliver or take possession of all materials to be delivered;

(2) without removal, render unusable or eliminate the capability to exercise contractual rights in or use of the licensed information or informational rights and any other materials to be delivered;

(3) destroy or prevent access to any materials to be delivered; and

(4) require that the party or any other person in possession or control of the materials to be delivered assemble and make them available to the other party at a place designated by that party which is reasonably convenient to both parties.

(d) In an appropriate case, injunctive relief may be granted to enforce the rights under this section.

Definitional Cross References. "Contract": Section 1-201. "Court": Section 2B-102. "Electronic": Section 2B-102. "Information": Section 2B-102. "Informational Rights": Section 2B-102. "License": Section 2B-102. "Party": Section 2B-102. "Person": Section 2B-102. "Rights": Section 1-201"Term". Section 1-201. "Termination". Section 2B-102.

Official Comments:

1. *Obligation to Return.* Subsection (a) states the unexceptional principle that an expiration of the contract, the party is entitled to materials held by the other party that it owns or that the contract provides are to be returned at the end of the relationship. The obligation is conditioned by a reference to commercially reasonable efforts to deliver because of the difficulties that may be involved in modern systems with multiple back-up systems. A reasonable effort here, however, does not include any intent or knowing retention of copies and is subject to subsection (b) which defines any use of the information after termination as a breach.

2. *Termination of Rights of Use.* Under subsection (b), termination ends future rights of use unless those rights are stated to survive or are otherwise irrevocable. This is a natural by-product of the conditional nature of a license. Continued use that is not authorized by the terminated license constitutes a breach of contract. Where intellectual property rights are involved, that use will often also constitute an infringement of those rights.

PART 7

REMEDIES

[A. In General]

2B-701. REMEDIES IN GENERAL.

(a) The rights and remedies provided in this article are cumulative, but a party may not recover more than once for the same loss.

(b) A court may deny or limit a remedy other than liquidated damages if, under the circumstances, the remedy would put the aggrieved party in a substantially better position than if the other party had fully performed.

(c) Except as otherwise provided in Sections 2B-703 and 2B-704, if a party is in breach of contract, whether or not the breach is material, the aggrieved party has the rights and remedies provided in the agreement and this article, but the aggrieved party shall continue to comply with contractual use restrictions with respect to information or copies that have not been returned or are not returnable to the party in breach. The aggrieved party also has the rights and remedies under other law, including applicable intellectual property law.

Uniform Law Source: Section 2A-523.

Definitional Cross References.

"Agreement": Section 1-201. "Aggrieved party": Section 1-201. "Contract": Section 1-201. "Contractual use restriction": Section 2B-102. "Court": Section 2B-102. "Information": Section 2B-102. "Party": Section 2B-102. "Remedy": Section 1-201. "Rights": Section 1-201.

Official Comments:

1. *General Purpose of Remedies.* The basic theme of contract remedies is set out in Article 1. The goal is to place an aggrieved party in the position that would occur if performance had occurred as agreed. Section 1-106(1) provides that "remedies ... shall be administered to the end that the aggrieved party may be put in as good a position as if the other party had fully performed." That principle applies to Article 2B.

2. *Cumulative Remedies.* The remedies in this article are cumulative to the extent that is consistent with the general goal of remedy rules. Article 2B rejects any concept of election of remedies.

3. *Aggrieved Party Choice.* The damage and other remedies in Article 2B allow the injured party to choose its remedy, subject to the substantive limitations applicable under this Article or the agreement of the parties. To prevent abuse, subsection (b) gives a court a limited right to deny a remedy if the remedy would place the injured party in a substantially better position than performance would have. This is a general review power, applicable only to the court to be exercised to prevent extreme abuse. It does not justify close scrutiny of the remedies chosen by an injured party, but only a broad review to prevent substantial injustice. The basic model adopted here gives the primary right of choice to the injured party, not the court, and uses the substantial over-compensation as a safeguard.

2B-702. CANCELLATION.

(a) Except as provided in Section 2B-609(b), a party may cancel a contract if:

(1) there is a material breach of the entire contract which has not been cured or waived; or

(2) the agreement allows cancellation for the breach.

(b) On cancellation, the following rules apply:

(1) A party in possession or control of information, documentation, materials, or copies shall take the following actionscomply with:

(A) A party that rightfully refused a copy, shall comply with Section 2B-612(b) as to any rightfully refused copy that remains in the possession or control of the party that refused the copy to the extent the rights and duties under that Section are not inconsistent with other provisions of this Section.; and

(B) A party in breach and in possession or control of a copy or any copies made from it, information, documentation or other materials that would be subject to an obligation to return under Section 2B-627, shall deliver all copies, access material and other material, and documentation pertaining to the copies to the other party or hold them with reasonable care for a reasonable time for disposal at that party's instructions. The party shall follow any reasonable instructions received from the party for delivery of the copies.

(C) Except as provided in paragraphs (A) and (B), the party shall comply with Section 2B-627 as to all other information, documentation, materials, or copies.

(2) All obligations that are executory on both sides at the time of cancellation are discharged except that the rights, duties, and remedies described in Section 2B-625(b) survive.

(3) Cancellation of a license ends any right of the licensee to use the information, informational rights, or copies under the license.

(c) A term providing that a contract may not be canceled precludes cancellation but does not limit other rights and remedies.

(d) Unless a contrary intention clearly appears, an expression such as "cancellation" or "rescission" or the like shall not be construed as a renunciation or discharge of a claim in damages for an antecedent breach.

Uniform Law Source: 2A-505; Sections 2-106(3)(4), 2-720, 2-721.

Definitional Cross Reference:

"Agreement": Section 1-201. "Cancellation": Section 2B-102. "Contract": Section 1-201. "Information": Section 2B-102. "Informational Rights": Section 2B-102. "License": Section 2B-102. "Party": Section 2B-102. "Rights": Section 1-201. "Term". Section 1-201.

Official Comments:

1. *Nature of Cancellation.* Cancellation means putting an end to the contract for breach as compared to termination because the contract expired. Cancellation terminates executory obligations but not rights earned by prior performance or fixed as a result of prior breach.

2. *Cancellation: Breach of Entire Contract.* A right to cancel exists if the breaching party's conduct constitutes a material breach of the entire contract **or** if the contract gives a right to cancel under the circumstances.

What constitutes a material breach of the entire contract depends on the nature of the breach and the agreement. Courts should draw on Section 2B-109 and case law from licensing and other contexts on what constitutes a material breach. The concept of a breach material as to the entire contract is also found in Article 2A (Section 2A-523) and Article 2 (installment contracts).

A material breach does not require that the aggrieved party cancel. The aggrieved party may continue to perform, demand reciprocal performance, and collect damages. However, if the injured party does not cancel and the breaching party cures the breach, cure precludes cancellation based on the cured breach.

3. *Cancellation: Ongoing Contracts.* Cancellation is important in two ways. First, it ends the injured party's duty to continue to perform executory obligations. Thus, for example, cancellation in a continuous access contract ends the access provider's obligation to make access available. Second, cancellation ends the contractual permission for future uses.

A license grants permission to the licensee to use, access or take other designated actions without an infringement claim by the licensor. If the license is canceled, that "defense" dissolves; a licensee who continues to act in a manner inconsistent with any underlying intellectual property rights of the licensor exposes itself to an infringement claim. See **Schoenberg v. Shapolsky Publishers, Inc.**, 971 F.2d 926 (2d Cir. 1992); **Costello Publishing Co. v. Rotelle**, 670 F.2d 1035 (D.C. Cir. 1981); **Kamakazi Music Corp. v. Robbins Music Corp.,** 684 F.2d 228 (2d Cir.1982).

4. *Cancellation and Federal Jurisdiction.* Cancellation affects judicial jurisdiction if the information is covered by federal intellectual property rights. A copyright or patent infringement claim is under exclusive federal jurisdiction. To sue for infringement for post-breach conduct of the licensee (in addition to or in lieu of breach of contract), the licensor must prove that the contract no longer permits the licensee to act.

2B-703. CONTRACTUAL MODIFICATION OF REMEDY.

(a) An agreement may provide for remedies in addition to or in substitution for those provided in this article and may limit or alter the measure of damages or a party's other remedies, such as by:

(1) precluding a party's right to cancel for breach of contract;

(2) limiting remedies to return or delivery of copies and refund of the contract fee; or

(3) limiting the remedies to repair or replacement.

(b) Resort to a contractual remedy is optional unless the remedy is expressly agreed to be exclusive, in which case it is the sole remedy. If the performance of the exclusive remedy by the party in breach causes the remedy to fail of its essential purpose, the exclusive remedy fails. If the exclusive remedy fails, subject to subsection (c), the aggrieved party is entitled to other remedies under this article.

(c) Failure or unconscionability of an agreed remedy does not affect the enforceability of terms disclaiming or limiting consequential or incidental damages if the contract expressly makes those terms independent of the agreed remedy.

(d) Consequential damages and incidental damages may be disclaimed or limited by agreement unless the disclaimer or limitation is unconscionable. Limitation or disclaimer or disclaimer of consequential damages for injury to the person in the case of a consumer transaction for a computer program contained in consumer goods is prima facie unconscionable, but limitation or disclaimer of damages where the loss is commercial is not.

Uniform Law Source: Section 2-719.

Definitional Cross References.

"Aggrieved party": Section 1-201. "Agreement": Section 1-201. "Cancel": Section 2B-102. "Computer program": Section 2B-102. "Consequential damages": Section 2B-102. "Consumer": Section 2B-102. "Consumer transaction": Section 2B-102. "Contract": Section 1-201. "Contract fee": Section 2B-102. "Delivery": Section 2B-102. "Incidental damages": Section 2B-102. "Party": Section 2B-102. "Person": Section 2B-102. "Refund": Section 2B-102. "Remedy": Section 1-201. "Rights": Section 1-201. "Term". Section 1-201.

Official Comments:

1. *Agreement Controls.* Subsection (a) recognizes the right of parties to contractually limit remedies. The right to control remedies by agreement is a fundamental facet of contract practice and the use of agreements to delimit risks.

2. *Listed Illustrations.* Subsection (a) lists illustrative remedy limitations that are common in commercial practice. The limited remedy of "replacement, repair or refund" is used in some information industries and clearly suffices as a limited remedy.

Subsection (a) also lists a remedy (barring cancellation) that is specifically relevant in information transactions where the licensee commits significant resources to the development and exploitation of information licensed to it from the licensor. The ability to waive the right to cancel for breach is important in that environment.

The illustrations in subsection (a) are not an exclusive list.

2. *Exclusive Remedies.* A contractual remedy is not an exclusive remedy unless the contract expressly so provides. The second sentence of subsection (b) follows current Article 2.

Subsection (c) resolves a frequently litigated issue of the effect of failure of a remedy on a contractual exclusion of consequential damages. This is a contract interpretation issue. It asks whether one clause (consequential damages) is dependent (or independent) of the other (limited exclusive remedy). Article 2B provides that the clauses are independent if expressly made so by the agreement. Under current Article 2, cases split, but most hold that the failure of one remedy does not exclude enforceability of the other in commercial contracts.

3. *Minimum Adequate Remedy.* Article 2B follows current Article 2 and does not regulate by setting a floor on the ability of parties to define remedies by contract. It does not require that the remedy at least provide a "minimum adequate remedy" to the injured licensor or licensee. Standards of unconscionability and tests for the formation of a binding contract adequately set floors on what agreed terms are binding.

The Comments to current Article 2-719 tie the idea of a minimum adequate remedy to two legal analyses, both of which are present under this Draft. In one respect, they seem to refer to an idea of a failure of mutuality or consideration and resulting questions about the enforceability of the entire contract. (e.g., "If the parties intend to conclude a contract for sale ... they must accept the legal consequence that there be at least a fair quantum of remedy ..."). Alternatively, the concept is connected in the comments to the idea of unconscionability, a standard against which all contract clauses are tested in this Article. (e.g., "Thus any clause purporting to modify or limit the remedial provisions of this Article in an unconscionable manner is subject to deletion ...").

4. *Consequential Damage Limitation: General.* Subsection (d) follows Article 2.

5. *Consequential Damage Limitations: Personal Injury.* Personal injury caused by breach of contract is potentially a form of consequential damages. Article 2 precludes disclaimer of personal injury damages in consumer goods cases. Disclaimer or limitation is otherwise permitted. Article 2B follows that theme with reference to software in consumer goods.

In other information contracts, modern cases do not use contract principles to create liability for personal injury against an information provider. In fact, most cases do not allow personal injury recovery even under tort theories. This Article adopts the sales law presumption only in reference to those settings where the that exclusion of personal injury loss in **consumer** cases is prima facie unconscionable. For other information, an assumption of this type is not appropriate.

2B-704. LIQUIDATION OF DAMAGES; DEPOSITS.

(a) Damages caused by a breach of contract by either party may be liquidated by agreement in an amount that is reasonable in light of the actual loss, the loss anticipated at the time of contracting, or the actual or anticipated difficulties of proving loss in the event of breach. A term fixing unreasonably large liquidated damages is void as a penalty.

(b) If a party justifiably withholds delivery of copies because of the other party's breach of contract, the party in breach is entitled to restitution of any amount by which the sum of the payments it made for the copies exceeds the amount to which the other party is entitled by virtue of the term liquidating damages in accordance with subsection (a). The right to restitution is subject to offset to the extent that the aggrieved party establishes:

(1) a right to recover damages under the provisions of this article other than subsection (a); and

(2) the amount or value of any benefits received by the party in breach, directly or indirectly, by reason of the contract.

Uniform Law Source: 2-718.

Definitional Cross References.

"Aggrieved party": Section 1-201. "Contract": Section 1-201. "Delivery": Section 2B-102. "Party": Section 2B-102. "Rights": Section 1-201. "Term". Section 1-201. "Value": Section 1-201.

Official Comments:

1. *General Standard.* Terms liquidating damages are one method of allocating risk in a contractual relationship. Subsection (a) adopts a standard that enforces any clause liquidating damages if the clause is reasonable based on either the anticipated losses, the actual loss incurred, *or* the difficulties of proof.

If the liquidated damage amount chosen by the parties is based on their assessment of risk at the time of the contract, that choice should be enforced. A court should not revisit the deal after the fact and disallow a contractual choice because the choice later appeared to disadvantage one party. Among other results, this approach indicates that, if the parties actually negotiated the clause, that clause is per se reasonable. Actual negotiation, however, is not essential to the enforceability of the term.

2. *Restitution.* Subsection (b) carries forward Article 2 concepts.

2B-705. STATUTE OF LIMITATIONS.

(a) An action for breach of contract must be commenced within the later of four years after the right of action accrues or one year after the breach was or should have been discovered, but the action may not be commenced more than five years after the right of action accrues. By agreement, the parties may reduce the period of limitations to not less than one year after the right of action accrues but may not extend the period of limitations in their original agreement.

(b) Except as otherwise provided in subsection (c), a right of action accrues when the act or omission constituting a breach of contract occurs even if the aggrieved party did not know of the breach. A right of action for breach of warranty accrues when tender of delivery occurs. However, if the warranty expressly extends to future performance of the information or copy, the right of action accrues when the performance that constitutes the breach occurs or should have occurred, but not later than the date the warranty expires.

(c) In the following cases, a right of action accrues on the later of the date the act or omission constituting the breach of contract occurred or the date on which it was or should have been discovered by the aggrieved party, but in no event earlier than the date for delivery of a copy if the claim relates to information in the copy:

(1) a breach of warranty against third-party claims for

(A) infringement or misappropriation; or

(B) libel, defamation, or the like;

(2) a breach of contract involving a party's disclosure or misuse of confidential information; or

(3) a failure to provide an indemnity.

(d) If an action commenced within the period of limitation in this section is so terminated as to leave available a remedy by another action for the same breach or indemnity, the other action may be commenced after expiration of the period of limitation if the action is commenced within six months after termination of the first action unless the termination resulted from voluntary discontinuance or from dismissal for failure or neglect to prosecute.

(e) This section does not apply to a right of action that accrued before the effective date of this article.

Uniform Law Source: Section 2A-506; 2-725.

Definitional Cross References.

"Aggrieved party": Section 1-201. "Agreement": Section 1-201. "Contract": Section 1-201. "Copy": Section 2B-102. "Delivery": Section 2B-102. "Information": Section 2B-102. "Party": Section 2B-102. "Remedy": Section 1-201. "Rights": Section 1-201. "Termination". Section 2B-102.

Official Comments:

1. *Limitations Period.* Subsection (a) combines a discovery rule with a rule of repose. The primary rule requires the action to be brought within four years of the time that the claim accrues. A limited "discovery rule" applies, however, that extends this statutory period to a total of no more than five years because the breach was not discovered.

Subsection (a) follows current Article 2 and precludes contracting for a longer period of limitations than in the statute. This does not preclude "tolling agreements" in contract disputes.

2. *Accrual of Cause of Action.* Article 2B uses two rules for determining when the cause of action accrues. The primary rule is in subsection (b). The cause of action accrues when the **conduct constituting** a breach occurs or should have occurred. In warranties generally, this occurs on delivery of the information or service, even if the performance problem does not materialize until later.

This section does not adopt the rule that a warranty that expressly relates to future performance automatically changes the basic standard to a "discovery" rule. Rather, for such "future performance" warranties, the standard is that the cause of action arises when the future performance obligation is breached. If the warranty for future performance is time limited (e.g., one year warranty), the time of breach cannot be later than the expiration of that stated time.

3. *Discovery Rule.* Subsection (c) contains exceptions to the time of conduct rule. Each deals with a case in which, in the ordinary course, the breach may be undiscoverable until after the conduct creating it occurs.

SECTION 2B-706. REMEDIES FOR FRAUD. Remedies for material misrepresentation or fraud include all remedies available under this Article for non-fraudulent breach. Neither rescission nor a claim for rescission of the contract nor refusal or return of the information bars or is inconsistent with a claim for damages or other remedy.

Definitional Cross References.

"Contract": Section 1-201. "Information": Section 2B-102. "Remedy": Section 1-201.

Official Comments: Conforms to Article 2.

[B. Damages]

2B-707. MEASUREMENT OF DAMAGES IN GENERAL.

(a) The remedy for breach of contract for disclosure or misuse of information that is a trade secret or in which the aggrieved party has a right of confidentiality include as consequential damages compensation for the benefit obtained by the party in breach as a result of the breach.

(b) Except as otherwise provided in the agreement, an aggrieved party may not recover compensation for that part of a loss that could have been avoided by taking measures reasonable under the circumstances to avoid or reduce loss, including the maintenance before breach of contract of reasonable systems for backup or retrieval of information. The burden of establishing a failure of the aggrieved party to take measures reasonable under the circumstances is on the party in breach.

(bc) Neither party is entitled to recover:

(1) consequential damages for losses caused by the content of published informational content unless the agreement expressly so provides; or

(2) damages that are speculative.

(c) The remedy for breach of contract for disclosure or misuse of information that is a trade secret or in which the aggrieved party has a right of confidentiality include as consequential damages compensation for the benefit obtained by the party in breach as a result of the breach.

Definitional Cross References.

"Aggrieved party": Section 1-201. "Agreement": Section 1-201. "Consequential damages": "Contract": Section 1-201. Section 2B-102. "Direct damages": Section 2B-102. "Information": Section 2B-102."Informational content": Section 2B-102. "Party": Section 2B-102. "Present value": Section 2B-102. "Published informational content": Section 2B-102. "Remedy": Section 1-201. "Rights": Section 1-201. "Value": Section 1-201.

Official Comments:

1. *Mitigation.* Subsection (a) requires mitigation of damages and places the burden of proving a failure to mitigate on the party asserting the protection of the rule. The idea that an injured party must mitigate its damages permeates contract law, but has not previously been made explicit in the UCC. The basic principle flows from the idea that remedies are not punitive but compensatory. The injured party cannot act in a manner that enhances the loss

2. *Published Content.* Subsection (b) excludes consequential damages for "published informational content." Published informational content invokes many fundamental and important values of our society. Whether characterized as a First Amendment analysis or treated as a question of simple social policy, our culture has a valued interest in promoting the dissemination of information. This Article takes a position that supports and encourages distribution of information content to the public. This conforms to modern U.S. law. One aspect of promoting publication of information is to reduce the liability risk; that principle has generated a series of Supreme Court rulings that deal with defamation and libel.

As indicated in the definition of published informational content, the context is one in which the content provider does not deal directly with the data recipient in a special reliance setting. The information is compiled and published. Information systems of this type are typically low cost and high volume. They would be seriously impeded by high liability risk. With few exceptions, modern law recognizes the

liability limitations even under tort law. The Restatement of Torts, for example, limits exposure for negligent error in data to intended recipients and to "pecuniary loss" which corresponds to direct damages.

Illustration 1: Dow distributes stock market information through newspapers and on-line for $5 per hour or $1 per copy. Dupond, reviews the on-line information and trades 1 million shares of Acme at a price that causes a $10 million loss because the data were incorrect. If Dupond were in a relationship of reliance with Dow, consequential loss is recoverable. In this published content, Dupond cannot recover consequential loss.

Illustration 2: Disney licenses a motion picture to Vision. Vision shows the movie through an on-line access contract. One viewer who pays five dollars is shocked by the violence and spends a sleepless week. That customer should have no recovery at all, but if it can show that there was a breach, the individual could not recover consequential loss since this is published content.

3. *Speculative Damages.* The Article does not require proof with absolute certainty or mathematical precision. Consistent with the underlying principle of Article 1 that there be a liberal administration of the remedies of this Act, the remedies must be administered in a reasonable manner. However, this does not permit recovery of losses that are speculative or highly uncertain and therefore unproven.

See **Restatement (Second) of Contracts** 352 ("Damages are not recoverable for loss beyond the amount that the evidence permits to be established with reasonable certainty."). No change in law on this issue is intended; courts should continue to apply ordinary standards of fairness and evaluation of proof. For an illustration in an information transaction, see **Freund v. Washington Square Press, Inc.**, 34 N.Y.2d 379, 357 N.Y.S.2d 857, 314 N.E.2d 419 (1974).

4. *Confidential Information.* Subsection (c) confirms that one way of measuring loss in the case of confidentiality breaches is in terms of the value obtained by the breaching party. In essence, where a confidential relationship exists, the party has an expectation of the information not being misused and that expectation is entitled to protection. Lost value does not easily fit into the idea of damages resulting from breach. Yet, compensation for such loss is important. Where the breach of confidence gives benefits to a third party that are not realized directly or indirectly by the party to the contract, recovery for such results, if any, occurs under other law.

2B-708. LICENSOR'S DAMAGES.

(a) Subject to subsection (b), if there is a breach of contract by a licensee, the licensor may recover compensation for the loss resulting in the ordinary course from the particular breach or, if appropriate, as to the entire contract, the following, less expenses saved as a result of the breach to the extent not otherwise accounted for under this section:

(1) damages measured in any combination of the following ways but not to exceed the contract fee and market value of other consideration required under the contract for the performance that was the subject of the breach:

(A) the amount of accrued and unpaid contract fees and the value of other consideration earned but not received for:

(i) any performance accepted by the licensee; and

(ii) any performance to which Section 2B-604 applies;

(B) with respect to performances not covered by paragraph (1)(A), if the licensee repudiated or wrongfully refused the performance or the licensor rightfully canceled the contract and the breach of contract makes possible a substitute transaction by the licensor in the same information or informational rights under the same contractual use restrictions that would not have been possible in the absence of the breach, the amount of loss determined by the following:

(i) contract fees and the value of other consideration required for the performance less the proceeds of a commercially reasonable substitute transaction entered into by the licensor in good faith and without unreasonable delay; or

(ii) contract fees and the value of other consideration required for the performance less the market value as of the date of breach and place of performance of the licensor's performance under a substitute transaction with the same contractual use restrictions that reasonably could have occurred.

(C) with respect to performances not covered by paragraph (1)(A), iIf the breach of contract does not make possible a substitute transaction by the licensor in the same information or informational rights under same contractual use restrictions that would not have been possible in the absence of breach, lost profit, including in the calculation reasonable

overhead, that the licensor would have realized on acceptance and full payment for performance that was to be delivered to the licensee but was not because of the licensee's breach; or

(D) damages calculated in any manner that is reasonable; and

(2) subject to Section 2B-707(bc), any consequential and incidental damages.

(b) For purposes of this section, "market value" is determined as of the date of breach and place for performance.

(c) Damages or expenses that relate to events that may occur after the date of judgment, must be reduced to present value as of the date of judgment in calculating the amount awarded.

Uniform Law Source: Section 2A-528; Section 2-708.

Definitional Cross References. "Consequential damages": Section 2B-102; "Contract": Section 1-201. "Contract fee": Section 2B-102. "Direct damages": Section 2B-102; "Incidental damages": Section 2B-102; "Information": Section 2B-102; "Informational rights": Section 2B-102. "Licensee": Section 2B-102; "Licensor": Section 2B-102; Material Breach": Section 2B-109. "Present value": Section 2B-102. "Value": Section 1-201.

Official Comments:

1. *General Approach.* This section gives the licensor a right to elect damages under measures described in (a). The basic approach assumes that the aggrieved party chooses the method of computation, subject to judicial review on whether the choice substantially over-compensates or enables double recovery. No order of preference is stated for the options.

The formulas in (a) measure "direct damages" in terms of the difference in value between performance promised and received, not counting any lost expected benefits beyond the performance itself. The measure also includes reimbursement of value already given to the other party when appropriate. For licensors, direct damages are capped either by the contract fee for the breached performance or the market value of other consideration to be received. This does not include the loss of expected benefits from use of the expected performance in other contexts. If compensable, these are consequential, not direct damages.

Damages relating to future events (whether consequential or direct) are awarded based on present value as of the date of judgment. "Present value", a defined term, discounts the value of future payments or losses to a particular point in time. As to losses and expenses that have already occurred at this time, the present value standard does not apply. No change in law on pre-judgment interest is intended.

2. *Intangible Character of Subject Matter.* Licensor remedies differ from remedies for sellers under Article 2. The most significant difference lies in recognition of the intangible character of information. Article 2 focuses damages calculation on an assumption that the seller's loss lies in the disposition of the particular item (goods). For information, the particular copy (item) is not the focus. Given their ability to be recreated easily and rapidly, with little cost, information assets are prime candidates for damage computation focusing on profit lost, a scenario that in Article 2 is associated with so-called lost volume sellers. The basic principle, however, as applied to Article 2B transactions is not a matter of lost volume, but of whether the breach enables a substitute transaction that could not otherwise have occurred and the returns from which are properly considered in determining direct damages.

This Section provides that if a substitute transaction is made possible by the breach, it is considered in determining damages. In most cases of a non-exclusive license, however, additional transactions are not made possible by the breach because the non-exclusive nature of the license already permits additional transactions and the information involved is in principle subject to very low cost reproduction and redistribution. This is consistent with common law and explicitly recognizes that in effect, the information assets are available in relatively infinite supply.

3. *Computation Approaches.* The basic damages formulae describe direct damages and are capped in total recovery by the contract fee or the market value of other consideration to be received by the licensor. They yield the following results:

a. Accrued Fees and Consideration. Subsection (a)(1)(A) recognizes that the aggrieved licensor is entitled to recover any accrued and unpaid fees or the value of other consideration owed for information or services actually delivered. The fees are direct damages.

b. Measuring other Direct Damages. This Section outlines several approaches to direct damages in addition to unpaid fees.

A. Recovery Measured by Contract Fee: Substitute Transaction Enabled. Subsection (a)(1)(B) describes a recovery measured by the *present* value of unaccrued contract fees and other consideration less the value of an actual or hypothetical substitute transaction made possible by the breach. Subsection (c) indicates the time at which the present value is determined.

i. Certainty. The future contract fees or other consideration must be proven with sufficient certainty to allow recovery. Speculative damages are not recoverable. The reasonable certainty principle is recognized in the **Restatement** and throughout common law. **Restatement (Second) of Contracts** 352.

ii. Substitute Transaction. The recovery is reduced by due allowance for the proceeds of a substitute transaction made possible by the breach as measured either by an actual substitute transaction or the market value of a hypothetical transaction that could have been made. This is a specific application of the concept of mitigation.

The substitute transaction must have been made possible by the breach. Thus, in a breach of a non-exclusive access contract by the licensee, the substitute transaction concept would not reduce recovery if the licensor had essentially unlimited capability to make access available to others. While a new access contract may occur after breach, it was not made possible by breach - the new license would have occurred with or without the breach. In most non-exclusive licenses, breach does not enable a new transaction in the sense intended in this Section. On the other hand, breach and cancellation of a licensed exclusive right to show a work in a particular geographic area may enable a substitute license for that area that could not have been made because of the exclusive nature of the breached license.

If the breach makes possible a substitute transaction, but no such transaction actually occurs, the recovery is reduced by the proven market value (if any exists) of the substitute that could have occurred. As with the actual transaction standard, market value of a hypothetical substitute should only be considered if the substitute was made possible by the breach and had the same use restrictions for the same information.

B. Recovery Measured by Lost Profits. Subsection (a)(1)(C) provides as an alternative that losses may be measured by lost profits caused by a failure to accept performance or by repudiation of the contract. The computation of what profits would have occurred in the event of performance necessarily would take into account the expenses of performance by the licensor. Courts should refer to common law cases on licenses and to cases under the lost profit concept in Article 2. Unlike in Article 2, however, use of this standard does not require proof that the alternative standards are inadequate to compensate the licensor. The injured party chooses the method of computation.

As with contract fees, lost profits must be proven with reasonable certainty and not merely speculative. **Restatement (Second) of Contracts** 352. Similarly, recovery is subject to the general duty to mitigate. See **Krafsur v. UOP**, (In re El Paso Refinery), 196 BR 58 (Bankr. WD Tex. 1996).

C. Measurement in an Reasonable Manner. Subsection (a)(1)(C) recognizes that the diversity of contexts present in this field make the specific formulae useful, but potentially inapplicable in some cases. Direct damages ordinarily refer to the value of the performance received or expected as measured by contract terms, while consequential loss refers to foreseeable loss resulting from the inability to use the performance.

c. Consequential and Incidental Damages. The licensor is also entitled, in an appropriate case, to recover consequential and incidental damages. The section distinguishes between contract fees and royalties on the one hand (as direct damages) and consequential damages on the other.

4. *Illustrative Situations.*

Illustration 1: Chambers licenses a master disk of its software to Wilson and allows Wilson to make and distribute 10,000 copies. This is a nonexclusive license. The fee is $1 million. The cost of the disk is $5. Wilson refuses the disk and repudiates the contract. Under (a)(1)(B), Chambers recovers $1 million less the $5, as also reduced by due allowance for (1) any substitute transaction made possible by this breach and (2) by any other failure to mitigate. The creation of a second 10,000 copy license is not a substitute if the license was not made possible by the breach. If it is not, recovery under subsection (a)(1)(C) is determined by assessing what portion of the contract price constitutes lost profit.

Illustration 2: Same as in Illustration 1, except that the license requires Chambers to deliver manuals, boxes and other materials for Wilson to distribute. The cost of these materials is $800,000. The $800,000 savings is deducted from the $1 million. Assume that there was a substitute transaction as meant in this Section. In awarding damages, a court must take into account that the expense adjustment must accommodate the alternative transaction.

Illustration 3: Same as Illustration 1, but the license was a worldwide **exclusive** license. On breach, Chambers makes an identical license with Second for a fee of $900,000. This transaction was

possible because the first exclusive license was canceled. Chambers recovery is $100,000 less any net cost savings not accounted for in the second transaction.

Illustration 4: Parkins grants an exclusive U.S. license to Telemart to distribute copies of Parkins' copyrighted digital encyclopedia. This is a ten year license at $50,000 per year. In Year 2, Telemart breaches and Parkins cancels. Its recovery is the present value of the remaining contract fees with due allowance for substitute transactions made possible by the breach. Since the license was exclusive, Parkins must reduce its recovery by the actual return or market value of any new license made possible.

Illustration 5. Producer receives a promise to be paid $10,000 for information that cost $1,000 and a commitment of 3% royalties for any sales of copies. The licensee repudiates the contract. As direct damages, Producer receives $10,000 less any expenses saved. The future royalty can be recovered as consequential damages, but only if proven with reasonable certainty.

5. *Remedies under Other Law.* The licensor may have remedies under other law. The primary alternative is intellectual property law. Breach introduces the possibility of an infringement claim if (a) the breach results in cancellation (rescission) of the license and the licensee's continuing conduct is inconsistent with the licensor's property rights, or (b) the breach consists of acting outside the scope of the license and in violation of the intellectual property right.

Intellectual property remedies do not displace contract remedies provisions since they deal with different issues. The two remedies may raise dual recovery issues in some cases. The general rule is that all remedies are cumulative, except that double recovery is not permitted.

2B-709. LICENSEE'S DAMAGES.

(a) Subject to subsection (b), if there is a breach of contract by a licensor, the licensee may recover compensation for the loss resulting in the ordinary course from the particular breach or, if appropriate, as to the entire contract, the following, less expenses saved as a result of the breach to the extent not otherwise accounted for under this section:

(1) damages measured in any combination of the following ways but not to exceed the market value of the performance that was the subject of the breach plus restitution of any amounts paid for performance not received and not accounted for within recovery of the market value:

(A) for performance that has been accepted and the acceptance not justifiably revoked, the value of the performance required less the value of the performance accepted as of the time and place of acceptance;

(B) for performance that has not been rendered or that was rightfully refused or acceptance of which was revoked:

(i) the amount of any payments made and the value of other consideration given to the licensor with respect to that performance and not previously returned to the licensee;

(ii) the market value, as of the date of breach, of the performance, less the contract fee for that performance; or

(iii) the difference between the cost of a commercially reasonable substitute transaction actually entered into by the licensee in good faith and without unreasonable delay for substantially similar information with the same contractual use restrictions, less the contract fee under the breached contract; or

(C) damages calculated in any manner that is reasonable; and

(2) subject to Section 2B-707(bc), incidental and consequential damages.

(b) The amount of damages must be reduced by any unpaid contract fees for performance by the licensor which has been accepted by the licensee and as to which the acceptance has not been rightfully revoked.

(c) For purposes of this section, "market value" is determined as of the date of breach and place for performance.

(d) Damages or expenses that relate to events that may occur after the date of judgment must be reduced to the present value as of the date of judgment in calculating the amount awarded.

Uniform Law Source: Section 2A-518; Section 2A-519(1)(2).

Definitional Cross Reference: "Consequential damages": Section 2B-102. "Contract": Section 1-201. "Contract fee": Section 2B-102. "Contractual use restriction": Section 2B-102. "Direct damages": Section 2B-102. "Incidental damages": Section 2B-102. "Information": Section 2B-102. "Informational

rights"" Section 2B-102. "Licensee": Section 2B-102. "Licensor": Section 2B-102. "Material breach": Section 2B-109. "Present value": Section 2B-102. "Term". Section 1-201. "Value": Section 1-201.

Official Comments:

1. *General Structure.* As with licensor remedies, this section allows the licensee to choose among alternatives to fit its circumstances. The aggrieved party's choice is subject only to the prohibition on double recovery and to the court's right to prevent excessive recovery under Section 2B-701. Because of the diverse issues involved in breach of a license, Article 2B eliminates the hierarchy in current Article 2. It nevertheless retains much of the conceptual framework from in Article 2, preserving both market value and cover approaches to computing damages.

The formulae in subsection (a)(1) measure direct damages. They are capped by the market value of the performance that was breached plus restitution of fees paid for which performance was not received. Market value refers to the cost that would be charged in a similar transaction. Thus, the formulae measure "direct damages" in terms of the difference in value between performance promised and received, not counting any lost expected benefits from use of the expected performance in other contexts. If compensable, these are consequential, not direct damages. This rejects cases such as Chatlos which incorporate into direct damages an assessment of how valuable to the aggrieved party the use of the expected performance would have been

Subsection (d) provides that damages as to future events are awarded based on present value as of the date of judgment. "Present value", a defined term, provides for discounting the value of future payments or losses as measured at a particular point in time. As applied to damages, this requires that, *as to damages awarded for eventualities that are in the future*, the court do so based on a present value standard. As to losses and expenses that have already occurred at this time, the present value measurement does not apply. No change in the law on pre-judgment interest is intended.

2. *Computational Approaches.*

A. Value of Delivered Performance. Subsection (a)(1)(A) allows recovery of the difference in the expected value for performance accepted or performance that cannot be returned, and the actual value as received. As indicated by the general cap and the focus on direct, as compared to consequential damages, the expected value will generally be measured by the contract fee or the market value of the accepted performance. Under the definition of direct damages, the damages are the difference between the value of the performance received and the value of the performance promised as measured by contract or market value. Recovery of losses in excess of that amount is in the nature of consequential damage recovery.

As a general rule, the value of the performance as it would be in the absence of a defect, focuses on the market value of the property which most often equals the agreed price. This Article rejects the approach of the few courts that compute direct damages accounting for perceived potential benefits from use, a concept more appropriately entailed in computation of consequential damages. This section, however, allows recovery based on the cost of repairs incurred to bring the product to the represented or warranted quality.

B*. Recovery of Fees.* Subsection (a)(1)(B)(i) confirms that the licensee is entitled to recover any fees paid for which performance was not received. Performance has not been provided if the licensor fails to make a required delivery, repudiates, the licensee rightfully rejects or justifiably revokes acceptance, or if the performance was executory at the time the licensee justifiably canceled.

C*. Market and Cover.* Subsection (a)(1)(B)(i) and (B)(ii) parallel Article 2 by comparing contract price to the market value of performance not received or to the cost of cover replacing that performance with a substitute. The subsection enables recovery based on the difference between the contract cost and "market value" of the performance, less expenses saved by virtue of breach. Subsection (B)(ii) recognizes the right to cover and provides that recovery can be computed based on a commercially reasonable cover containing the same contractual use restrictions as the original contract.

D*. Measured in any Reasonable Manner.* Subsection (a)(1)(C) authorizes the licensee to compute damages in any manner that is reasonable. This provides a response to the many situations that cannot be predicted in advance and to instruct the parties and the courts to rely on reasonable standards. The measurement, while open-ended in computation technique, is limited to the type of damages discussed here.

3*. Consequential and Incidental Damages.* The licensee may also recover incidental and consequential damages in an appropriate case. If proven with reasonable certainty, damages can include lost profits.

4**.** *Illustrative Cases.*

Illustration 1: Amoco contracts for a 1,000 person site license for database software from Meed. The contract fee is $500,000 in initial payment and $10,000 for each month of use. The contract term is

two years. Amoco makes the first payment, but Meed fails to deliver a functioning system. Amoco cancels the contract and obtains a substitute system under a three year contract for $400,000 and $9,000 per month. It is entitled to return of the $500,000 payment plus recovery of the difference between the contract price ($240,000 computed to present value) and the market price for the software. The court should consider to what extent this second transaction defines the market value in light of differences in the terms of the license and the nature of the software and other relevant variables.

Illustration 2: Same facts as in Illustration 1, but Amoco obtains a license for Meed software from an authorized distributor (Jones) for a $600,000 initial fee under other terms identical to the Meed contract. Since the new contract gives Amoco recovery of its initial payment, the $100,000 difference, and any incidental or consequential damages.

Illustration 3: Assume that, rather than being completely defective, the database system lacks one element that was promised. While Amoco could reject the software, it elects to accept the license. It sues for damages. The issue is establishing the difference in value between a proper system and the one delivered. Assume that the difference is $150,000. Amoco recovers that amount as direct damages, along with any incidental or consequential damages.

2B-710. RECOUPMENT.

(a) Except as otherwise provided in subsection (b), an aggrieved party, upon notifying the party in breach of contract of its intention to do so, may deduct all or any part of the damages resulting from the breach from any payments still due under the same contract.

(b) If a breach of contract is not material with reference to the particular performance, an aggrieved party may exercise its rights under subsection (a) only if the agreement does not require further affirmative performance by the other party and the amount of damages deducted can be readily liquidated under the agreement.

Uniform Law Source: Section 2-717.

Definitional Cross References. "Aggrieved party": Section 1-201. "Agreement": Section 1-201. "Contract": Section 1-201. "Material breach": Section 2B-109. "Party": Section 2B-102. "Rights": Section 1-201.

Official Comments:

1. *Basic Standard.* Subsection (a) allows recoupment to either party in light of the fact that payment streams from which losses can be recouped can flow in either direction in an Article 2B transaction. This is a form of self-help. The injured party can employ self-help by diminishing the amount that it pays under the contract.

2. *Non-material Breaches.* Subsection (b) limits the recoupment rule in cases of nonmaterial breach involving ongoing performance contracts. Article 2 does not deal with this because it generally does not focus on ongoing contracts or recognize a distinction between material and nonmaterial breach.

[C. Performance Remedies]

2B-711. SPECIFIC PERFORMANCE.

(a) Specific performance may be decreed, if:

(1) the agreement expressly provides for that remedy, other than for an obligation for the payment of money;

(2) the contract was not for personal services but the agreed performance is unique; or

(3) in other proper circumstances.

(b) A decree for specific performance may contain any terms and conditions considered just but the decree must provide adequate safeguards consistent with the terms of the contract to protect confidential information, information, and informational rights of the party ordered to perform.

Uniform Law Source: 2A-521. Section 2-716. Revised.

Definitional Cross References. "Contract": Section 1-201. "Court": Section 2B-102. "Information": Section 2B-102. "Informational Rights": Section 2B-102. "Party": Section 2B-102. "Person": Section 2B-102. "Remedy": Section 1-201. "Term". Section 1-201.

Official Comments:

1. *Contracted For Remedy*. Subsection (a) allows the parties to contract for specific performance, so long as a court can administer that remedy. This excludes the obligation to pay a fee, however, since

collection of a fee is essentially a monetary judgment and not appropriate for specific performance themes.

2. *Judicial Remedy.* Subsection (a)(2) states the substantive standard for specific performance. It follows Article 2. Compare **Restatement (Second) of Contracts** § 357, Introductory note. Specific performance cannot be ordered for a "personal services contract."

Despite the often unique character of intangibles, respect for a licensor's property and confidentiality interests often precludes specific performance allowing continued use of the property unless the need is compelling. See **Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc**., 756 F.2d 1043 (4th Cir. 1985); **Johnson & Johnson Orthopedics, Inc. v. Minnesota Mining & Manufacturing Co.,** 715 F. Supp. 110 (D. Del. 1989).

3. *Conditioning the Order.* Subsection (b) recognizes judicial discretion, but provides an important protection for confidential information relevant for both the licensor and the licensee where performance would jeopardize interests in confidential information of the party. Confidentiality and intellectual property interests must be dealt with in any specific performance award.

2B-712. LICENSOR'S RIGHT TO COMPLETE. Upon breach of contract by a licensee, a licensor, in the exercise of reasonable commercial judgment for the purposes of avoiding loss and of effective realization, may complete the information and identify it to the contract, cease work on it, relicense or dispose of it consistent with Sections 2B-502 and 2B-503, or proceed in any other reasonable manner. The licensor remains bound by all contractual use restrictions on information of the licensee. The licensor may recover damages and pursue other remedies that have not been waived.

Uniform Law Source: Section 2A-524(2); 2-704(2). Revised.

Definitional Cross References. "Contract": Section 1-201. "Information": Section 2B-102. "Licensee". Section 2B-102. "Licensor": Section 2B-102. "Rights": Section 1-201.

Official Comments:

A licensor faced with material breach by the licensee while work is in process may complete the work or not. Having made the choice in good faith and in a commercially reasonable manner, the licensor is entitled to remedies based on the situation in which it finds itself following the choice.

2B-713. LICENSEE'S RIGHT TO CONTINUE USE. Upon breach of contract by a licensor, a licensee that has not canceled the contract may continue to use the information and informational rights under the contract. If the licensee elects to continue to use the information or informational rights, the following rules apply:

(1) Except as otherwise provided in paragraphs (2) and (3), the licensee is bound by all of the terms of the contract, including contractual use restrictions or noncompetition obligations, and any obligations to pay contract fees.

(2) The licensee may pursue any remedy for breach that has not been waived.

(3) The licensor's rights remain in effect as if the licensor had not been in breach but are subject to the licensee's remedy for breach.

Definitional Cross References. "Agreement": Section 1-201. "Cancel": Section 2B-102. "Contract": Section 1-201. "Contract fee": Section 2B-102. "Contractual use restriction": Section 2B-102. "Information": Section 2B-102. "Informational Rights": Section 2B-102. "Licensee". Section 2B-102. "Licensor": Section 2B-102. "Remedy": Section 1-201. "Rights": Section 1-201. "Term". Section 1-201.

Official Comments:

This section allows the licensee's to continue use and sue for breach if it elects to accept a flawed performance and not cancel the contract. If the licensee elects to continue use, it remains bound by the contract terms as if no breach occurred, except, of course, for its right to a remedy for breach. Among the remedies that might be appropriate is the remedy of recoupment.

2B-714. RIGHT TO DISCONTINUE. Notwithstanding Section 2B-715, in the event of a material breach of an access contract or if the agreement so provides, a party may discontinue all contractual rights of access of the party in breach and direct any other person that is assisting the performance of the contract to discontinue its performance.

Definitional Cross References. "Access contract": Section 2B-102. "Agreement": Section 1-201. "Party": Section 2B-102. "Person": Section 2B-102. "Rights": Section 1-201.

Notes:

1. *Right to Deny Access.* This section deals with the right of a party in an access contract to stop performance. The ability to act quickly in an access contract is potentially critical to party's ability to

avoid continuing liability risk, as might occur where the basis of the breach includes use of the access system to distribute infringing, libelous, or otherwise damaging material. It corresponds to common law principles regarding access to facilities - treating these as arrangements subject to cancellation at will by the party who controls the facility unless the contract otherwise provides. See **Ticketron Ltd. Partnership v. Flip Side, Inc.,** No. 92-C-0911, 1993 WESTLAW 214164 (ND Ill. June 17, 1993).

2. *Not Related to Retaking Transfers.* This section does not create a right to retake transfers already made, but merely to stop future performance. Article 2 and Article 2A are similar in reference to the seller's (lessor) right to stop delivery of goods in transit. This Section does not create special rules for cases of insolvency.

2B-715. RIGHT TO POSSESSION AND TO PREVENT USE.

(a) Upon cancellation of a license, the licensor has the right:

(1) to possession of all copies of the licensed information in the possession or control of the licensee and any other materials pertaining to that information which by contract were to be returned or delivered by the licensee to the licensor; and

(2) to prevent the continued exercise of contractual and informational rights in the licensed information under the license.

(b) A licensor may exercise its rights under subsection (a) without judicial process only if this can be done:

(1) without a breach of the peace; and

(2) without a foreseeable risk of personal injury or significant damage to information or property other than the licensed information.

(c) In a judicial proceeding, a court may enjoin a licensee in breach of contract from continued use of the information and the informational rights and may order that the licensor or a judicial officer take the steps described in Section 2B-627.

(d) A party has a right to an expedited judicial hearing on prejudgment relief to enforce or protect its rights under this section.

(e) The right to possession under this section is not available to the extent that the information, before breach of the license and in the ordinary course of performance under the license, was so altered or commingled that the information is no longer identifiable or separable.

(f) A licensee that provides information to a licensor subject to contractual use restrictions has the rights and is subject to the limitations of a licensor under this section with respect to the information it provides.

Uniform Law Source: Section 2A-525, 526; Section 9-503. Revised.

Definitional Cross References. "Cancellation": Section 2B-102. "Contract": Section 1-201. "Court": Section 2B-102. "Information": Section 2B-102. "Informational Rights": Section 2B-102. "License": Section 2B-102. "Licensee". Section 2B-102. "Licensor": Section 2B-102. "Party": Section 2B-102. "Rights": Section 1-201.

Official Comments:

1. *Scope and Policy.* This section only applies to licenses and only if the license is canceled for breach. This section recognizes the injured party's right to recover the information and prevent use by the breaching party. The remedies are analogous to those in Article 2A. The right to possession and to control further use of information held by the other party may be exercised and relevant to either the licensor or the licensee.

2. *Rights Recognized.* Subsection (a) recognizes two rights for the injured party. It can obtain possession of all copies of the information and, when appropriate, obtain an injunction against further use of the information. The combination is necessary to fully implement the intent that, on cancellation of the license, the injured party has a full right to preclude further benefits to the breaching party resulting from the licensed information. In many cases involving informational content, merely returning all copies does not achieve that result.

3. *Self-help.* A license is a conditional transfer. Subsection (b) provides a right of self-help consistent with Article 2A and Article 9. The self-help right is constrained by 1) there being a breach sufficient to cancel the license and 2) the ability to exercise self-help without causing a "breach of the peace" or a foreseeable risk of personal injury or significant damage to information or property other than the licensed information. This places more restrictions on self-help than in Article 2A or Article 9. As in both of those articles, this Section takes no position on whether self help can be pursued through electronic means.

4. *Expedited Hearing.* Subsection (d) provides for a right to an expedited hearing to enforce rights or possession and restriction of use. No effort has been made to define the contours of what that hearing timing may entail. This is left to state procedural law.

5. *Identifiability.* As indicated in subsection (e), there must be something identifiable with reference to which the rights can be applied. The right to possession of copies cannot exist if the copies have been so commingled as to have lost their identifiability. This deals, for example, with cases where data are thoroughly intermingled with data of the other party **and** that intermingling occurs in the ordinary performance under the license. In such cases, repossession is impossible because of the expected performance of the parties under the contract.

This limitation does not necessarily apply to the right to prevent use. For example, if trade secret information was provided to the licensee under use restrictions, the ability to prevent further use hinges solely on whether a particular activity can be identified as involving use of the information. If an image, trademark, name or similar material is inseparable from other property of the party in breach, that does not preclude the injured party from preventing further use of the information by the party in breach. Thus, a license of the "Mickey Mouse" character which results in placing that image in a video game produced by the party in breach does not prevent the other party from barring continued use of the image on the hats in commerce.

ARTICLE 3 - NEGOTIABLE INSTRUMENTS

PART 1. GENERAL PROVISIONS AND DEFINITIONS

3-101. SHORT TITLE.

This Article may be cited as Uniform Commercial Code -- Negotiable Instruments.

3-102. SUBJECT MATTER.

(a) This Article applies to negotiable instruments. It does not apply to money, to payment orders governed by Article 4A, or to securities governed by Article 8.

(b) If there is conflict between this Article and Article 4 or 9, Articles 4 and 9 govern.

(c) Regulations of the Board of Governors of the Federal Reserve System and operating circulars of the Federal Reserve Banks supersede any inconsistent provision of this Article to the extent of the inconsistency.

3-103. DEFINITIONS.

(a) In this Article:

(1) "**Acceptor**" means a drawee who has accepted a draft.

(2) "**Consumer account**" means an account established by an individual primarily for personal, family, or household purposes.

(3) "**Consumer transaction**" means a transaction in which an individual incurs an obligation primarily for personal, family, or household purposes.

(4) "**Drawee**" means a person ordered in a draft to make payment.

(5) "**Drawer**" means a person who signs or is identified in a draft as a person ordering payment.

(6) [reserved]

(7) "**Maker**" means a person who signs or is identified in a note as a person undertaking to pay.

(8) "**Order**" means a written instruction to pay money signed by the person giving the instruction. The instruction may be addressed to any person, including the person giving the instruction, or to one or more persons jointly or in the alternative but not in succession. An authorization to pay is not an order unless the person authorized to pay is also instructed to pay.

(9) "**Ordinary care**" in the case of a person engaged in business means observance of reasonable commercial standards, prevailing in the area in which the person is located, with respect to the business in which the person is engaged. In the case of a bank that takes an instrument for processing for collection or payment by automated means, reasonable commercial standards do not require the bank to examine the instrument if the failure to examine does not violate the bank's prescribed procedures and the bank's procedures do not vary unreasonably from general banking usage not disapproved by this Article or Article 4.

(10) "**Party**" means a party to an instrument.

(11) "**Principal obligor**," with respect to an instrument, means the accommodated party or any other party to the instrument against whom a secondary obligor has recourse under this article.

(12) "**Promise**" means a written undertaking to pay money signed by the person undertaking to pay. An acknowledgment of an obligation by the obligor is not a promise unless the obligor also undertakes to pay the obligation.

(13) "**Prove**" with respect to a fact means to meet the burden of establishing the fact (Section 1-201(b)(8)).

(14) [reserved]

(15) "**Remitter**" means a person who purchases an instrument from its issuer if the instrument is payable to an identified person other than the purchaser.

(16) "**Remotely-created consumer item**" means an item drawn on a consumer account, which is not created by the payor bank and does not bear a handwritten signature purporting to be the signature of the drawer.

(17) "**Secondary obligor**," with respect to an instrument, means (a) an indorser or an accommodation party, (b) a drawer having the obligation described in Section 3-414(d), or (c) any other party to the instrument that has recourse against another party to the instrument pursuant to Section 3-116(b).

(b) Other definitions applying to this Article and the sections in which they appear are:

"**Acceptance**"	Section 3-409
"**Accommodated party**"	Section 3-419
"**Accommodation party**"	Section 3-419
"**Account**"	Section 4-104
"**Alteration**"	Section 3-407
"**Anomalous indorsement**"	Section 3-205
"**Blank indorsement**"	Section 3-205
"**Cashier's check**"	Section 3-104
"**Certificate of deposit**"	Section 3-104
"**Certified check**"	Section 3-409
"**Check**"	Section 3-104
"**Consideration**"	Section 3-303
"**Draft**"	Section 3-104
"**Holder in due course**"	Section 3-302
"**Incomplete instrument**"	Section 3-115
"**Indorsement**"	Section 3-204
"**Indorser**"	Section 3-204
"**Instrument**"	Section 3-104
"**Issue**"	Section 3-105
"**Issuer**"	Section 3-105
"**Negotiable instrument**"	Section 3-104
"**Negotiation**"	Section 3-201
"**Note**"	Section 3-104
"**Payable at a definite time**"	Section 3-108
"**Payable on demand**"	Section 3-108
"**Payable to bearer**"	Section 3-109
"**Payable to order**"	Section 3-109
"**Payment**"	Section 3-602
"**Person entitled to enforce**"	Section 3-301
"**Presentment**"	Section 3-501

"**Reacquisition**"	Section 3-207
"**Special indorsement**"	Section 3-205
"**Teller's check**"	Section 3-104
"**Transfer of instrument**"	Section 3-203
"**Traveler's check**"	Section 3-104
"**Value**"	Section 3-303

(c) The following definitions in other Articles apply to this Article:

"**Banking day**"	Section 4-104
"**Clearing house**"	Section 4-104
"**Collecting bank**"	Section 4-105
"**Depositary bank**"	Section 4-105
"**Documentary draft**"	Section 4-104
"**Intermediary bank**"	Section 4-105
"**Item**"	Section 4-104
"**Payor bank**"	Section 4-105
"**Suspends payments**"	Section 4-104

(d) In addition, Article 1 contains general definitions and principles of construction and interpretation applicable throughout this Article.

3-104. NEGOTIABLE INSTRUMENT.

(a) Except as provided in subsections (c) and (d), "**negotiable instrument**" means an unconditional promise or order to pay a fixed amount of money, with or without interest or other charges described in the promise or order, if it:

(1) is payable to bearer or to order at the time it is issued or first comes into possession of a holder;

(2) is payable on demand or at a definite time; and

(3) does not state any other undertaking or instruction by the person promising or ordering payment to do any act in addition to the payment of money, but the promise or order may contain (i) an undertaking or power to give, maintain, or protect collateral to secure payment, (ii) an authorization or power to the holder to confess judgment or realize on or dispose of collateral, or (iii) a waiver of the benefit of any law intended for the advantage or protection of an obligor.

(b) "**Instrument**" means a negotiable instrument.

(c) An order that meets all of the requirements of subsection (a), except paragraph (1), and otherwise falls within the definition of "check" in subsection (f) is a negotiable instrument and a check.

(d) A promise or order other than a check is not an instrument if, at the time it is issued or first comes into possession of a holder, it contains a conspicuous statement, however expressed, to the effect that the promise or order is not negotiable or is not an instrument governed by this Article.

(e) An instrument is a "**note**" if it is a promise and is a "**draft**" if it is an order. If an instrument falls within the definition of both "note" and "draft," a person entitled to enforce the instrument may treat it as either.

(f) "**Check**" means (i) a draft, other than a documentary draft, payable on demand and drawn on a bank or (ii) a cashier's check or teller's check. An instrument may be a check even though it is described on its face by another term, such as "money order."

(g) "**Cashier's check**" means a draft with respect to which the drawer and drawee are the same bank or branches of the same bank.

(h) "**Teller's check**" means a draft drawn by a bank (i) on another bank, or (ii) payable at or through a bank.

(i) "**Traveler's check**" means an instrument that (i) is payable on demand, (ii) is drawn on or payable at or through a bank, (iii) is designated by the term "traveler's check" or by a substantially similar term, and (iv) requires, as a condition to payment, a countersignature by a person whose specimen signature appears on the instrument.

(j) "**Certificate of deposit**" means an instrument containing an acknowledgment by a bank that a sum of money has been received by the bank and a promise by the bank to repay the sum of money. A certificate of deposit is a note of the bank.

3-105. ISSUE OF INSTRUMENT.

(a) "**Issue**" means the first delivery of an instrument by the maker or drawer, whether to a holder or nonholder, for the purpose of giving rights on the instrument to any person.

(b) An unissued instrument, or an unissued incomplete instrument that is completed, is binding on the maker or drawer, but nonissuance is a defense. An instrument that is conditionally issued or is issued for a special purpose is binding on the maker or drawer, but failure of the condition or special purpose to be fulfilled is a defense.

(c) "**Issuer**" applies to issued and unissued instruments and means a maker or drawer of an instrument.

3-106. UNCONDITIONAL PROMISE OR ORDER.

(a) Except as provided in this section, for the purposes of Section 3-104(a), a promise or order is unconditional unless it states (i) an express condition to payment, (ii) that the promise or order is subject to or governed by another record, or (iii) that rights or obligations with respect to the promise or order are stated in another record. A reference to another record does not of itself make the promise or order conditional.

(b) A promise or order is not made conditional (i) by a reference to another record for a statement of rights with respect to collateral, prepayment, or acceleration, or (ii) because payment is limited to resort to a particular fund or source.

(c) If a promise or order requires, as a condition to payment, a countersignature by a person whose specimen signature appears on the promise or order, the condition does not make the promise or order conditional for the purposes of Section 3-104(a). If the person whose specimen signature appears on an instrument fails to countersign the instrument, the failure to countersign is a defense to the obligation of the issuer, but the failure does not prevent a transferee of the instrument from becoming a holder of the instrument.

(d) If a promise or order at the time it is issued or first comes into possession of a holder contains a statement, required by applicable statutory or administrative law, to the effect that the rights of a holder or transferee are subject to claims or defenses that the issuer could assert against the original payee, the promise or order is not thereby made conditional for the purposes of Section 3-104(a); but if the promise or order is an instrument, there cannot be a holder in due course of the instrument.

3-107. INSTRUMENT PAYABLE IN FOREIGN MONEY.

Unless the instrument otherwise provides, an instrument that states the amount payable in foreign money may be paid in the foreign money or in an equivalent amount in dollars calculated by using the current bank-offered spot rate at the place of payment for the purchase of dollars on the day on which the instrument is paid.

3-108. PAYABLE ON DEMAND OR AT DEFINITE TIME.

(a) A promise or order is "**payable on demand**" if it (i) states that it is payable on demand or at sight, or otherwise indicates that it is payable at the will of the holder, or (ii) does not state any time of payment.

(b) A promise or order is "**payable at a definite time**" if it is payable on elapse of a definite period of time after sight or acceptance or at a fixed date or dates or at a time or times readily ascertainable at the time the promise or order is issued, subject to rights of (i) prepayment, (ii) acceleration, (iii) extension at the option of the holder, or (iv) extension to a further definite time at the option of the maker or acceptor or automatically upon or after a specified act or event.

(c) If an instrument, payable at a fixed date, is also payable upon demand made before the fixed date, the instrument is payable on demand until the fixed date and, if demand for payment is not made before that date, becomes payable at a definite time on the fixed date.

3-109. PAYABLE TO BEARER OR TO ORDER.

(a) A promise or order is payable to bearer if it:

(1) states that it is payable to bearer or to the order of bearer or otherwise indicates that the person in possession of the promise or order is entitled to payment;

(2) does not state a payee; or

(3) states that it is payable to or to the order of cash or otherwise indicates that it is not payable to an identified person.

(b) A promise or order that is not payable to bearer is payable to order if it is payable (i) to the order of an identified person or (ii) to an identified person or order. A promise or order that is payable to order is payable to the identified person.

(c) An instrument payable to bearer may become payable to an identified person if it is specially indorsed pursuant to Section 3-205(a). An instrument payable to an identified person may become payable to bearer if it is indorsed in blank pursuant to Section 3-205(b).

3-110. IDENTIFICATION OF PERSON TO WHOM INSTRUMENT IS PAYABLE.

(a) The person to whom an instrument is initially payable is determined by the intent of the person, whether or not authorized, signing as, or in the name or behalf of, the issuer of the instrument. The instrument is payable to the person intended by the signer even if that person is identified in the instrument by a name or other identification that is not that of the intended person. If more than one person signs in the name or behalf of the issuer of an instrument and all the signers do not intend the same person as payee, the instrument is payable to any person intended by one or more of the signers.

(b) If the signature of the issuer of an instrument is made by automated means, such as a check-writing machine, the payee of the instrument is determined by the intent of the person who supplied the name or identification of the payee, whether or not authorized to do so.

(c) A person to whom an instrument is payable may be identified in any way, including by name, identifying number, office, or account number. For the purpose of determining the holder of an instrument, the following rules apply:

(1) If an instrument is payable to an account and the account is identified only by number, the instrument is payable to the person to whom the account is payable. If an instrument is payable to an account identified by number and by the name of a person, the instrument is payable to the named person, whether or not that person is the owner of the account identified by number.

(2) If an instrument is payable to:

(i) a trust, an estate, or a person described as trustee or representative of a trust or estate, the instrument is payable to the trustee, the representative, or a successor of either, whether or not the beneficiary or estate is also named;

(ii) a person described as agent or similar representative of a named or identified person, the instrument is payable to the represented person, the representative, or a successor of the representative;

(iii) a fund or organization that is not a legal entity, the instrument is payable to a representative of the members of the fund or organization; or

(iv) an office or to a person described as holding an office, the instrument is payable to the named person, the incumbent of the office, or a successor to the incumbent.

(d) If an instrument is payable to two or more persons alternatively, it is payable to any of them and may be negotiated, discharged, or enforced by any or all of them in possession of the instrument. If an instrument is payable to two or more persons not alternatively, it is payable to all of them and may be negotiated, discharged, or enforced only by all of them. If an instrument payable to two or more persons is ambiguous as to whether it is payable to the persons alternatively, the instrument is payable to the persons alternatively.

3-111. PLACE OF PAYMENT.

Except as otherwise provided for items in Article 4, an instrument is payable at the place of payment stated in the instrument. If no place of payment is stated, an instrument is payable at the address of the drawee or maker stated in the instrument. If no address is stated, the place of payment is the place of business of the drawee or maker. If a drawee or maker has more than one place of business, the place of payment is any place of business of the drawee or maker chosen by the person entitled to enforce the instrument. If the drawee or maker has no place of business, the place of payment is the residence of the drawee or maker.

3-112. INTEREST.

(a) Unless otherwise provided in the instrument, (i) an instrument is not payable with interest, and (ii) interest on an interest-bearing instrument is payable from the date of the instrument.

(b) Interest may be stated in an instrument as a fixed or variable amount of money or it may be expressed as a fixed or variable rate or rates. The amount or rate of interest may be stated or

described in the instrument in any manner and may require reference to information not contained in the instrument. If an instrument provides for interest, but the amount of interest payable cannot be ascertained from the description, interest is payable at the judgment rate in effect at the place of payment of the instrument and at the time interest first accrues.

3-113. DATE OF INSTRUMENT.

(a) An instrument may be antedated or postdated. The date stated determines the time of payment if the instrument is payable at a fixed period after date. Except as provided in Section 4-401(c), an instrument payable on demand is not payable before the date of the instrument.

(b) If an instrument is undated, its date is the date of its issue or, in the case of an unissued instrument, the date it first comes into possession of a holder.

3-114. CONTRADICTORY TERMS OF INSTRUMENT.

If an instrument contains contradictory terms, typewritten terms prevail over printed terms, handwritten terms prevail over both, and words prevail over numbers.

3-115. INCOMPLETE INSTRUMENT.

(a) "**Incomplete instrument**" means a signed writing, whether or not issued by the signer, the contents of which show at the time of signing that it is incomplete but that the signer intended it to be completed by the addition of words or numbers.

(b) Subject to subsection (c), if an incomplete instrument is an instrument under Section 3-104, it may be enforced according to its terms if it is not completed, or according to its terms as augmented by completion. If an incomplete instrument is not an instrument under Section 3-104, but, after completion, the requirements of Section 3-104 are met, the instrument may be enforced according to its terms as augmented by completion.

(c) If words or numbers are added to an incomplete instrument without authority of the signer, there is an alteration of the incomplete instrument under Section 3-407.

(d) The burden of establishing that words or numbers were added to an incomplete instrument without authority of the signer is on the person asserting the lack of authority.

3-116. JOINT AND SEVERAL LIABILITY; CONTRIBUTION.

(a) Except as otherwise provided in the instrument, two or more persons who have the same liability on an instrument as makers, drawers, acceptors, indorsers who indorse as joint payees, or anomalous indorsers are jointly and severally liable in the capacity in which they sign.

(b) Except as provided in Section 3-419(e) or by agreement of the affected parties, a party having joint and several liability who pays the instrument is entitled to receive from any party having the same joint and several liability contribution in accordance with applicable law.

3-117. OTHER AGREEMENTS AFFECTING INSTRUMENT.

Subject to applicable law regarding exclusion of proof of contemporaneous or previous agreements, the obligation of a party to an instrument to pay the instrument may be modified, supplemented, or nullified by a separate agreement of the obligor and a person entitled to enforce the instrument, if the instrument is issued or the obligation is incurred in reliance on the agreement or as part of the same transaction giving rise to the agreement. To the extent an obligation is modified, supplemented, or nullified by an agreement under this section, the agreement is a defense to the obligation.

3-118. STATUTE OF LIMITATIONS.

(a) Except as provided in subsection (e), an action to enforce the obligation of a party to pay a note payable at a definite time must be commenced within six years after the due date or dates stated in the note or, if a due date is accelerated, within six years after the accelerated due date.

(b) Except as provided in subsection (d) or (e), if demand for payment is made to the maker of a note payable on demand, an action to enforce the obligation of a party to pay the note must be commenced within six years after the demand. If no demand for payment is made to the maker, an action to enforce the note is barred if neither principal nor interest on the note has been paid for a continuous period of 10 years.

(c) Except as provided in subsection (d), an action to enforce the obligation of a party to an unaccepted draft to pay the draft must be commenced within three years after dishonor of the draft or 10 years after the date of the draft, whichever period expires first.

(d) An action to enforce the obligation of the acceptor of a certified check or the issuer of a teller's check, cashier's check, or traveler's check must be commenced within three years after demand for payment is made to the acceptor or issuer, as the case may be.

(e) An action to enforce the obligation of a party to a certificate of deposit to pay the instrument must be commenced within six years after demand for payment is made to the maker, but if the instrument states a due date and the maker is not required to pay before that date, the six-year period begins when a demand for payment is in effect and the due date has passed.

(f) An action to enforce the obligation of a party to pay an accepted draft, other than a certified check, must be commenced (i) within six years after the due date or dates stated in the draft or acceptance if the obligation of the acceptor is payable at a definite time, or (ii) within six years after the date of the acceptance if the obligation of the acceptor is payable on demand.

(g) Unless governed by other law regarding claims for indemnity or contribution, an action (i) for conversion of an instrument, for money had and received, or like action based on conversion, (ii) for breach of warranty, or (iii) to enforce an obligation, duty, or right arising under this Article and not governed by this section must be commenced within three years after the [cause of action] accrues.

3-119. NOTICE OF RIGHT TO DEFEND ACTION.

In an action for breach of an obligation for which a third person is answerable over pursuant to this Article or Article 4, the defendant may give the third person notice of the litigation in a record, and the person notified may then give similar notice to any other person who is answerable over. If the notice states (i) that the person notified may come in and defend and (ii) that failure to do so will bind the person notified in an action later brought by the person giving the notice as to any determination of fact common to the two litigations, the person notified is so bound unless after seasonable receipt of the notice the person notified does come in and defend.

PART 2. NEGOTIATION, TRANSFER, AND INDORSEMENT [Table of Contents]

3-201. NEGOTIATION.

(a) "**Negotiation**" means a transfer of possession, whether voluntary or involuntary, of an instrument by a person other than the issuer to a person who thereby becomes its holder.

(b) Except for negotiation by a remitter, if an instrument is payable to an identified person, negotiation requires transfer of possession of the instrument and its indorsement by the holder. If an instrument is payable to bearer, it may be negotiated by transfer of possession alone.

3-202. NEGOTIATION SUBJECT TO RESCISSION.

(a) Negotiation is effective even if obtained (i) from an infant, a corporation exceeding its powers, or a person without capacity, (ii) by fraud, duress, or mistake, or (iii) in breach of duty or as part of an illegal transaction.

(b) To the extent permitted by other law, negotiation may be rescinded or may be subject to other remedies, but those remedies may not be asserted against a subsequent holder in due course or a person paying the instrument in good faith and without knowledge of facts that are a basis for rescission or other remedy.

3-203. TRANSFER OF INSTRUMENT; RIGHTS ACQUIRED BY TRANSFER.

(a) An instrument is transferred when it is delivered by a person other than its issuer for the purpose of giving to the person receiving delivery the right to enforce the instrument.

(b) Transfer of an instrument, whether or not the transfer is a negotiation, vests in the transferee any right of the transferor to enforce the instrument, including any right as a holder in due course, but the transferee cannot acquire rights of a holder in due course by a transfer, directly or indirectly, from a holder in due course if the transferee engaged in fraud or illegality affecting the instrument.

(c) Unless otherwise agreed, if an instrument is transferred for value and the transferee does not become a holder because of lack of indorsement by the transferor, the transferee has a specifically enforceable right to the unqualified indorsement of the transferor, but negotiation of the instrument does not occur until the indorsement is made.

(d) If a transferor purports to transfer less than the entire instrument, negotiation of the instrument does not occur. The transferee obtains no rights under this Article and has only the rights of a partial assignee.

3-204. INDORSEMENT.

(a) "**Indorsement**" means a signature, other than that of a signer as maker, drawer, or acceptor, that alone or accompanied by other words is made on an instrument for the purpose of (i) negotiating the

instrument, (ii) restricting payment of the instrument, or (iii) incurring indorser's liability on the instrument, but regardless of the intent of the signer, a signature and its accompanying words is an indorsement unless the accompanying words, terms of the instrument, place of the signature, or other circumstances unambiguously indicate that the signature was made for a purpose other than indorsement. For the purpose of determining whether a signature is made on an instrument, a paper affixed to the instrument is a part of the instrument.

(b) "**Indorser**" means a person who makes an indorsement.

(c) For the purpose of determining whether the transferee of an instrument is a holder, an indorsement that transfers a security interest in the instrument is effective as an unqualified indorsement of the instrument.

(d) If an instrument is payable to a holder under a name that is not the name of the holder, indorsement may be made by the holder in the name stated in the instrument or in the holder's name or both, but signature in both names may be required by a person paying or taking the instrument for value or collection.

3-205. SPECIAL INDORSEMENT; BLANK INDORSEMENT; ANOMALOUS INDORSEMENT.

(a) If an indorsement is made by the holder of an instrument, whether payable to an identified person or payable to bearer, and the indorsement identifies a person to whom it makes the instrument payable, it is a "**special indorsement**." When specially indorsed, an instrument becomes payable to the identified person and may be negotiated only by the indorsement of that person. The principles stated in Section 3-110 apply to special indorsements.

(b) If an indorsement is made by the holder of an instrument and it is not a special indorsement, it is a "**blank indorsement**." When indorsed in blank, an instrument becomes payable to bearer and may be negotiated by transfer of possession alone until specially indorsed.

(c) The holder may convert a blank indorsement that consists only of a signature into a special indorsement by writing, above the signature of the indorser, words identifying the person to whom the instrument is made payable.

(d) "**Anomalous indorsement**" means an indorsement made by a person who is not the holder of the instrument. An anomalous indorsement does not affect the manner in which the instrument may be negotiated.

3-206. RESTRICTIVE INDORSEMENT.

(a) An indorsement limiting payment to a particular person or otherwise prohibiting further transfer or negotiation of the instrument is not effective to prevent further transfer or negotiation of the instrument.

(b) An indorsement stating a condition to the right of the indorsee to receive payment does not affect the right of the indorsee to enforce the instrument. A person paying the instrument or taking it for value or collection may disregard the condition, and the rights and liabilities of that person are not affected by whether the condition has been fulfilled.

(c) If an instrument bears an indorsement (i) described in Section 4-201(b), or (ii) in blank or to a particular bank using the words "for deposit," "for collection," or other words indicating a purpose of having the instrument collected by a bank for the indorser or for a particular account, the following rules apply:

(1) A person, other than a bank, who purchases the instrument when so indorsed converts the instrument unless the amount paid for the instrument is received by the indorser or applied consistently with the indorsement.

(2) A depositary bank that purchases the instrument or takes it for collection when so indorsed converts the instrument unless the amount paid by the bank with respect to the instrument is received by the indorser or applied consistently with the indorsement.

(3) A payor bank that is also the depositary bank or that takes the instrument for immediate payment over the counter from a person other than a collecting bank converts the instrument unless the proceeds of the instrument are received by the indorser or applied consistently with the indorsement.

(4) Except as otherwise provided in paragraph (3), a payor bank or intermediary bank may disregard the indorsement and is not liable if the proceeds of the instrument are not received by the indorser or applied consistently with the indorsement.

(d) Except for an indorsement covered by subsection (c), if an instrument bears an indorsement using words to the effect that payment is to be made to the indorsee as agent, trustee, or other fiduciary for the benefit of the indorser or another person, the following rules apply:

(1) Unless there is notice of breach of fiduciary duty as provided in Section 3-307, a person who purchases the instrument from the indorsee or takes the instrument from the indorsee for collection or payment may pay the proceeds of payment or the value given for the instrument to the indorsee without regard to whether the indorsee violates a fiduciary duty to the indorser.

(2) A subsequent transferee of the instrument or person who pays the instrument is neither given notice nor otherwise affected by the restriction in the indorsement unless the transferee or payor knows that the fiduciary dealt with the instrument or its proceeds in breach of fiduciary duty.

(e) The presence on an instrument of an indorsement to which this section applies does not prevent a purchaser of the instrument from becoming a holder in due course of the instrument unless the purchaser is a converter under subsection (c) or has notice or knowledge of breach of fiduciary duty as stated in subsection (d).

(f) In an action to enforce the obligation of a party to pay the instrument, the obligor has a defense if payment would violate an indorsement to which this section applies and the payment is not permitted by this section.

3-207. REACQUISITION.

Reacquisition of an instrument occurs if it is transferred to a former holder, by negotiation or otherwise. A former holder who reacquires the instrument may cancel indorsements made after the reacquirer first became a holder of the instrument. If the cancellation causes the instrument to be payable to the reacquirer or to bearer, the reacquirer may negotiate the instrument. An indorser whose indorsement is canceled is discharged, and the discharge is effective against any subsequent holder.

PART 3. ENFORCEMENT OF INSTRUMENTS [Table of Contents]

3-301. PERSON ENTITLED TO ENFORCE INSTRUMENT.

"**Person entitled to enforce**" an instrument means (i) the holder of the instrument, (ii) a nonholder in possession of the instrument who has the rights of a holder, or (iii) a person not in possession of the instrument who is entitled to enforce the instrument pursuant to Section 3-309 or 3-418(d). A person may be a person entitled to enforce the instrument even though the person is not the owner of the instrument or is in wrongful possession of the instrument.

3-302. HOLDER IN DUE COURSE.

(a) Subject to subsection (c) and Section 3-106(d), "**holder in due course**" means the holder of an instrument if:

(1) the instrument when issued or negotiated to the holder does not bear such apparent evidence of forgery or alteration or is not otherwise so irregular or incomplete as to call into question its authenticity; and

(2) the holder took the instrument (i) for value, (ii) in good faith, (iii) without notice that the instrument is overdue or has been dishonored or that there is an uncured default with respect to payment of another instrument issued as part of the same series, (iv) without notice that the instrument contains an unauthorized signature or has been altered, (v) without notice of any claim to the instrument described in Section 3-306, and (vi) without notice that any party has a defense or claim in recoupment described in Section 3-305(a).

(b) Notice of discharge of a party, other than discharge in an insolvency proceeding, is not notice of a defense under subsection (a), but discharge is effective against a person who became a holder in due course with notice of the discharge. Public filing or recording of a document does not of itself constitute notice of a defense, claim in recoupment, or claim to the instrument.

(c) Except to the extent a transferor or predecessor in interest has rights as a holder in due course, a person does not acquire rights of a holder in due course of an instrument taken (i) by legal process or by purchase in an execution, bankruptcy, or creditor's sale or similar proceeding, (ii) by purchase as part of a bulk transaction not in ordinary course of business of the transferor, or (iii) as the successor in interest to an estate or other organization.

(d) If, under Section 3-303(a)(1), the promise of performance that is the consideration for an instrument has been partially performed, the holder may assert rights as a holder in due course of the instrument only to the fraction of the amount payable under the instrument equal to the value of the partial performance divided by the value of the promised performance.

(e) If (i) the person entitled to enforce an instrument has only a security interest in the instrument and (ii) the person obliged to pay the instrument has a defense, claim in recoupment, or claim to the instrument that may be asserted against the person who granted the security interest, the person entitled to enforce the instrument may assert rights as a holder in due course only to an amount payable under the instrument which, at the time of enforcement of the instrument, does not exceed the amount of the unpaid obligation secured.

(f) To be effective, notice must be received at a time and in a manner that gives a reasonable opportunity to act on it.

(g) This section is subject to any law limiting status as a holder in due course in particular classes of transactions.

3-303. VALUE AND CONSIDERATION.

(a) An instrument is issued or transferred for value if:

(1) the instrument is issued or transferred for a promise of performance, to the extent the promise has been performed;

(2) the transferee acquires a security interest or other lien in the instrument other than a lien obtained by judicial proceeding;

(3) the instrument is issued or transferred as payment of, or as security for, an antecedent claim against any person, whether or not the claim is due;

(4) the instrument is issued or transferred in exchange for a negotiable instrument; or

(5) the instrument is issued or transferred in exchange for the incurring of an irrevocable obligation to a third party by the person taking the instrument.

(b) "**Consideration**" means any consideration sufficient to support a simple contract. The drawer or maker of an instrument has a defense if the instrument is issued without consideration. If an instrument is issued for a promise of performance, the issuer has a defense to the extent performance of the promise is due and the promise has not been performed. If an instrument is issued for value as stated in subsection (a), the instrument is also issued for consideration.

3-304. OVERDUE INSTRUMENT.

(a) An instrument payable on demand becomes overdue at the earliest of the following times:

(1) on the day after the day demand for payment is duly made;

(2) if the instrument is a check, 90 days after its date; or

(3) if the instrument is not a check, when the instrument has been outstanding for a period of time after its date which is unreasonably long under the circumstances of the particular case in light of the nature of the instrument and usage of the trade.

(b) With respect to an instrument payable at a definite time the following rules apply:

(1) If the principal is payable in installments and a due date has not been accelerated, the instrument becomes overdue upon default under the instrument for nonpayment of an installment, and the instrument remains overdue until the default is cured.

(2) If the principal is not payable in installments and the due date has not been accelerated, the instrument becomes overdue on the day after the due date.

(3) If a due date with respect to principal has been accelerated, the instrument becomes overdue on the day after the accelerated due date.

(c) Unless the due date of principal has been accelerated, an instrument does not become overdue if there is default in payment of interest but no default in payment of principal.

3-305. DEFENSES AND CLAIMS IN RECOUPMENT.

(a) Except as otherwise provided in this section, the right to enforce the obligation of a party to pay an instrument is subject to the following:

(1) a defense of the obligor based on (i) infancy of the obligor to the extent it is a defense to a simple contract, (ii) duress, lack of legal capacity, or illegality of the transaction which, under other law, nullifies the obligation of the obligor, (iii) fraud that induced the obligor to sign the instrument with neither knowledge nor reasonable opportunity to learn of its character or its essential terms, or (iv) discharge of the obligor in insolvency proceedings;

(2) a defense of the obligor stated in another section of this Article or a defense of the obligor that would be available if the person entitled to enforce the instrument were enforcing a right to payment under a simple contract; and

(3) a claim in recoupment of the obligor against the original payee of the instrument if the claim arose from the transaction that gave rise to the instrument; but the claim of the obligor may be asserted against a transferee of the instrument only to reduce the amount owing on the instrument at the time the action is brought.

(b) The right of a holder in due course to enforce the obligation of a party to pay the instrument is subject to defenses of the obligor stated in subsection (a)(1), but is not subject to defenses of the obligor stated in subsection (a)(2) or claims in recoupment stated in subsection (a)(3) against a person other than the holder.

(c) Except as stated in subsection (d), in an action to enforce the obligation of a party to pay the instrument, the obligor may not assert against the person entitled to enforce the instrument a defense, claim in recoupment, or claim to the instrument (Section 3-306) of another person, but the other person's claim to the instrument may be asserted by the obligor if the other person is joined in the action and personally asserts the claim against the person entitled to enforce the instrument. An obligor is not obliged to pay the instrument if the person seeking enforcement of the instrument does not have rights of a holder in due course and the obligor proves that the instrument is a lost or stolen instrument.

(d) In an action to enforce the obligation of an accommodation party to pay an instrument, the accommodation party may assert against the person entitled to enforce the instrument any defense or claim in recoupment under subsection (a) that the accommodated party could assert against the person entitled to enforce the instrument, except the defenses of discharge in insolvency proceedings, infancy, and lack of legal capacity.

(e) In a consumer transaction, if law other than this article requires that an instrument include a statement to the effect that the rights of a holder or transferee are subject to a claim or defense that the issuer could assert against the original payee, and the instrument does not include such a statement: (1) the instrument has the same effect as if the instrument included such a statement; (2) the issuer may assert against the holder or transferee all claims and defenses that would have been available if the instrument included such a statement; and (3) the extent to which claims may be asserted against the holder or transferee is determined as if the instrument included such a statement.

(f) This section is subject to law other than this article that establishes a different rule for consumer transactions.

3-306. CLAIMS TO AN INSTRUMENT.

A person taking an instrument, other than a person having rights of a holder in due course, is subject to a claim of a property or possessory right in the instrument or its proceeds, including a claim to rescind a negotiation and to recover the instrument or its proceeds. A person having rights of a holder in due course takes free of the claim to the instrument.

3-307. NOTICE OF BREACH OF FIDUCIARY DUTY.

(a) In this section:

(1) "**Fiduciary**" means an agent, trustee, partner, corporate officer or director, or other representative owing a fiduciary duty with respect to an instrument.

(2) "**Represented person**" means the principal, beneficiary, partnership, corporation, or other person to whom the duty stated in paragraph (1) is owed.

(b) If (i) an instrument is taken from a fiduciary for payment or collection or for value, (ii) the taker has knowledge of the fiduciary status of the fiduciary, and (iii) the represented person makes a claim to the instrument or its proceeds on the basis that the transaction of the fiduciary is a breach of fiduciary duty, the following rules apply:

(1) Notice of breach of fiduciary duty by the fiduciary is notice of the claim of the represented person.

(2) In the case of an instrument payable to the represented person or the fiduciary as such, the taker has notice of the breach of fiduciary duty if the instrument is (i) taken in payment of or as security for a debt known by the taker to be the personal debt of the fiduciary, (ii) taken in a transaction known by the taker to be for the personal benefit of the fiduciary, or (iii) deposited to an account other than an account of the fiduciary, as such, or an account of the represented person.

(3) If an instrument is issued by the represented person or the fiduciary as such, and made payable to the fiduciary personally, the taker does not have notice of the breach of fiduciary duty unless the taker knows of the breach of fiduciary duty.

(4) If an instrument is issued by the represented person or the fiduciary as such, to the taker as payee, the taker has notice of the breach of fiduciary duty if the instrument is (i) taken in payment of or as security for a debt known by the taker to be the personal debt of the fiduciary, (ii) taken in a transaction known by the taker to be for the personal benefit of the fiduciary, or (iii) deposited to an account other than an account of the fiduciary, as such, or an account of the represented person.

3-308. PROOF OF SIGNATURES AND STATUS AS HOLDER IN DUE COURSE.

(a) In an action with respect to an instrument, the authenticity of, and authority to make, each signature on the instrument is admitted unless specifically denied in the pleadings. If the validity of a signature is denied in the pleadings, the burden of establishing validity is on the person claiming validity, but the signature is presumed to be authentic and authorized unless the action is to enforce the liability of the purported signer and the signer is dead or incompetent at the time of trial of the issue of validity of the signature. If an action to enforce the instrument is brought against a person as the undisclosed principal of a person who signed the instrument as a party to the instrument, the plaintiff has the burden of establishing that the defendant is liable on the instrument as a represented person under Section 3-402(a).

(b) If the validity of signatures is admitted or proved and there is compliance with subsection (a), a plaintiff producing the instrument is entitled to payment if the plaintiff proves entitlement to enforce the instrument under Section 3-301, unless the defendant proves a defense or claim in recoupment. If a defense or claim in recoupment is proved, the right to payment of the plaintiff is subject to the defense or claim, except to the extent the plaintiff proves that the plaintiff has rights of a holder in due course which are not subject to the defense or claim.

3-309. ENFORCEMENT OF LOST, DESTROYED, OR STOLEN INSTRUMENT.

(a) A person not in possession of an instrument is entitled to enforce the instrument if:

(1) the person seeking to enforce the instrument

(A) was entitled to enforce it the instrument when loss of possession occurred, or

(B) has directly or indirectly acquired ownership of the instrument from a person who was entitled to enforce the instrument when loss of possession occurred;

(2) the loss of possession was not the result of a transfer by the person or a lawful seizure; and

(3) the person cannot reasonably obtain possession of the instrument because the instrument was destroyed, its whereabouts cannot be determined, or it is in the wrongful possession of an unknown person or a person that cannot be found or is not amenable to service of process.

(b) A person seeking enforcement of an instrument under subsection (a) must prove the terms of the instrument and the person's right to enforce the instrument. If that proof is made, Section 3-308 applies to the case as if the person seeking enforcement had produced the instrument. The court may not enter judgment in favor of the person seeking enforcement unless it finds that the person required to pay the instrument is adequately protected against loss that might occur by reason of a claim by another person to enforce the instrument. Adequate protection may be provided by any reasonable means.

3-310. EFFECT OF INSTRUMENT ON OBLIGATION FOR WHICH TAKEN.

(a) Unless otherwise agreed, if a certified check, cashier's check, or teller's check is taken for an obligation, the obligation is discharged to the same extent discharge would result if an amount of money equal to the amount of the instrument were taken in payment of the obligation. Discharge of the obligation does not affect any liability that the obligor may have as an indorser of the instrument.

(b) Unless otherwise agreed and except as provided in subsection (a), if a note or an uncertified check is taken for an obligation, the obligation is suspended to the same extent the obligation would be discharged if an amount of money equal to the amount of the instrument were taken, and the following rules apply:

(1) In the case of an uncertified check, suspension of the obligation continues until dishonor of the check or until it is paid or certified. Payment or certification of the check results in discharge of the obligation to the extent of the amount of the check.

(2) In the case of a note, suspension of the obligation continues until dishonor of the note or until it is paid. Payment of the note results in discharge of the obligation to the extent of the payment.

(3) Except as provided in paragraph (4), if the check or note is dishonored and the obligee of the obligation for which the instrument was taken is the person entitled to enforce the instrument, the obligee may enforce either the instrument or the obligation. In the case of an instrument of a third person which is negotiated to the obligee by the obligor, discharge of the obligor on the instrument also discharges the obligation.

(4) If the person entitled to enforce the instrument taken for an obligation is a person other than the obligee, the obligee may not enforce the obligation to the extent the obligation is suspended. If the obligee is the person entitled to enforce the instrument but no longer has possession of it because it was lost, stolen, or destroyed, the obligation may not be enforced to the extent of the amount payable on the instrument, and to that extent the obligee's rights against the obligor are limited to enforcement of the instrument.

(c) If an instrument other than one described in subsection (a) or (b) is taken for an obligation, the effect is (i) that stated in subsection (a) if the instrument is one on which a bank is liable as maker or acceptor, or (ii) that stated in subsection (b) in any other case.

3-311. ACCORD AND SATISFACTION BY USE OF INSTRUMENT.

(a) If a person against whom a claim is asserted proves that (i) that person in good faith tendered an instrument to the claimant as full satisfaction of the claim, (ii) the amount of the claim was unliquidated or subject to a bona fide dispute, and (iii) the claimant obtained payment of the instrument, the following subsections apply.

(b) Unless subsection (c) applies, the claim is discharged if the person against whom the claim is asserted proves that the instrument or an accompanying written communication contained a conspicuous statement to the effect that the instrument was tendered as full satisfaction of the claim.

(c) Subject to subsection (d), a claim is not discharged under subsection (b) if either of the following applies:

(1) The claimant, if an organization, proves that (i) within a reasonable time before the tender, the claimant sent a conspicuous statement to the person against whom the claim is asserted that communications concerning disputed debts, including an instrument tendered as full satisfaction of a debt, are to be sent to a designated person, office, or place, and (ii) the instrument or accompanying communication was not received by that designated person, office, or place.

(2) The claimant, whether or not an organization, proves that within 90 days after payment of the instrument, the claimant tendered repayment of the amount of the instrument to the person against whom the claim is asserted. This paragraph does not apply if the claimant is an organization that that sent a statement complying with paragraph (1)(i).

(d) A claim is discharged if the person against whom the claim is asserted proves that within a reasonable time before collection of the instrument was initiated, the claimant, or an agent of the claimant having direct responsibility with respect to the disputed obligation, knew that the instrument was tendered in full satisfaction of the claim.

3-312. LOST, DESTROYED, OR STOLEN CASHIER'S CHECK, TELLER'S CHECK, OR CERTIFIED CHECK.

(a) In this section:

(1) "**Check**" means a cashier's check, teller's check, or certified check.

(2) "**Claimant**" means a person who claims the right to receive the amount of a cashier's check, teller's check, or certified check that was lost, destroyed, or stolen.

(3) "**Declaration of loss**" means a statement, made in a record under penalty of perjury, to the effect that (i) the declarer lost possession of a check, (ii) the declarer is the drawer or payee of the check, in the case of a certified check, or the remitter or payee of the check, in the case of a cashier's check or teller's check, (iii) the loss of possession was not the result of a transfer by the declarer or a lawful seizure, and (iv) the declarer cannot reasonably obtain possession of the check because the check was destroyed, its whereabouts cannot be determined, or it is in the wrongful possession of an unknown person or a person that cannot be found or is not amenable to service of process.

(4) "**Obligated bank**" means the issuer of a cashier's check or teller's check or the acceptor of a certified check.

(b) A claimant may assert a claim to the amount of a check by a communication to the obligated bank describing the check with reasonable certainty and requesting payment of the amount of the check, if (i) the claimant is the drawer or payee of a certified check or the remitter or payee of a cashier's check or teller's check, (ii) the communication contains or is accompanied by a declaration

of loss of the claimant with respect to the check, (iii) the communication is received at a time and in a manner affording the bank a reasonable time to act on it before the check is paid, and (iv) the claimant provides reasonable identification if requested by the obligated bank. Delivery of a declaration of loss is a warranty of the truth of the statements made in the declaration. If a claim is asserted in compliance with this subsection, the following rules apply:

(1) The claim becomes enforceable at the later of (i) the time the claim is asserted, or (ii) the 90th day following the date of the check, in the case of a cashier's check or teller's check, or the 90th day following the date of the acceptance, in the case of a certified check.

(2) Until the claim becomes enforceable, it has no legal effect and the obligated bank may pay the check or, in the case of a teller's check, may permit the drawee to pay the check. Payment to a person entitled to enforce the check discharges all liability of the obligated bank with respect to the check.

(3) If the claim becomes enforceable before the check is presented for payment, the obligated bank is not obliged to pay the check.

(4) When the claim becomes enforceable, the obligated bank becomes obliged to pay the amount of the check to the claimant if payment of the check has not been made to a person entitled to enforce the check. Subject to Section 4-302(a)(1), payment to the claimant discharges all liability of the obligated bank with respect to the check.

(c) If the obligated bank pays the amount of a check to a claimant under subsection (b)(4) and the check is presented for payment by a person having rights of a holder in due course, the claimant is obliged to (i) refund the payment to the obligated bank if the check is paid, or (ii) pay the amount of the check to the person having rights of a holder in due course if the check is dishonored.

(d) If a claimant has the right to assert a claim under subsection (b) and is also a person entitled to enforce a cashier's check, teller's check, or certified check which is lost, destroyed, or stolen, the claimant may assert rights with respect to the check either under this section or Section 3-309.

PART 4. LIABILITY OF PARTIES [Table of Contents]

3-401. SIGNATURE.

(a) A person is not liable on an instrument unless (i) the person signed the instrument, or (ii) the person is represented by an agent or representative who signed the instrument and the signature is binding on the represented person under Section 3-402.

(b) A signature may be made (i) manually or by means of a device or machine, and (ii) by the use of any name, including a trade or assumed name, or by a word, mark, or symbol executed or adopted by a person with present intention to authenticate a writing.

3-402. SIGNATURE BY REPRESENTATIVE.

(a) If a person acting, or purporting to act, as a representative signs an instrument by signing either the name of the represented person or the name of the signer, the represented person is bound by the signature to the same extent the represented person would be bound if the signature were on a simple contract. If the represented person is bound, the signature of the representative is the "authorized signature of the represented person" and the represented person is liable on the instrument, whether or not identified in the instrument.

(b) If a representative signs the name of the representative to an instrument and the signature is an authorized signature of the represented person, the following rules apply:

(1) If the form of the signature shows unambiguously that the signature is made on behalf of the represented person who is identified in the instrument, the representative is not liable on the instrument.

(2) Subject to subsection (c), if (i) the form of the signature does not show unambiguously that the signature is made in a representative capacity or (ii) the represented person is not identified in the instrument, the representative is liable on the instrument to a holder in due course that took the instrument without notice that the representative was not intended to be liable on the instrument. With respect to any other person, the representative is liable on the instrument unless the representative proves that the original parties did not intend the representative to be liable on the instrument.

(c) If a representative signs the name of the representative as drawer of a check without indication of the representative status and the check is payable from an account of the represented person who is identified on the check, the signer is not liable on the check if the signature is an authorized signature of the represented person.

3-403. UNAUTHORIZED SIGNATURE.

(a) Unless otherwise provided in this Article or Article 4, an unauthorized signature is ineffective except as the signature of the unauthorized signer in favor of a person who in good faith pays the instrument or takes it for value. An unauthorized signature may be ratified for all purposes of this Article.

(b) If the signature of more than one person is required to constitute the authorized signature of an organization, the signature of the organization is unauthorized if one of the required signatures is lacking.

(c) The civil or criminal liability of a person who makes an unauthorized signature is not affected by any provision of this Article which makes the unauthorized signature effective for the purposes of this Article.

3-404. IMPOSTORS; FICTITIOUS PAYEES.

(a) If an impostor, by use of the mails or otherwise, induces the issuer of an instrument to issue the instrument to the impostor, or to a person acting in concert with the impostor, by impersonating the payee of the instrument or a person authorized to act for the payee, an indorsement of the instrument by any person in the name of the payee is effective as the indorsement of the payee in favor of a person who, in good faith, pays the instrument or takes it for value or for collection.

(b) If (i) a person whose intent determines to whom an instrument is payable (Section 3-110(a) or (b)) does not intend the person identified as payee to have any interest in the instrument, or (ii) the person identified as payee of an instrument is a fictitious person, the following rules apply until the instrument is negotiated by special indorsement:

(1) Any person in possession of the instrument is its holder.

(2) An indorsement by any person in the name of the payee stated in the instrument is effective as the indorsement of the payee in favor of a person who, in good faith, pays the instrument or takes it for value or for collection.

(c) Under subsection (a) or (b), an indorsement is made in the name of a payee if (i) it is made in a name substantially similar to that of the payee or (ii) the instrument, whether or not indorsed, is deposited in a depositary bank to an account in a name substantially similar to that of the payee.

(d) With respect to an instrument to which subsection (a) or (b) applies, if a person paying the instrument or taking it for value or for collection fails to exercise ordinary care in paying or taking the instrument and that failure substantially contributes to loss resulting from payment of the instrument, the person bearing the loss may recover from the person failing to exercise ordinary care to the extent the failure to exercise ordinary care contributed to the loss.

3-405. EMPLOYER'S RESPONSIBILITY FOR FRAUDULENT INDORSEMENT BY EMPLOYEE.

(a) In this section:

(1) "**Employee**" includes an independent contractor and employee of an independent contractor retained by the employer.

(2) "**Fraudulent indorsement**" means (i) in the case of an instrument payable to the employer, a forged indorsement purporting to be that of the employer, or (ii) in the case of an instrument with respect to which the employer is the issuer, a forged indorsement purporting to be that of the person identified as payee.

(3) "**Responsibility**" with respect to instruments means authority (i) to sign or indorse instruments on behalf of the employer, (ii) to process instruments received by the employer for bookkeeping purposes, for deposit to an account, or for other disposition, (iii) to prepare or process instruments for issue in the name of the employer, (iv) to supply information determining the names or addresses of payees of instruments to be issued in the name of the employer, (v) to control the disposition of instruments to be issued in the name of the employer, or (vi) to act otherwise with respect to instruments in a responsible capacity. "Responsibility" does not include authority that merely allows an employee to have access to instruments or blank or incomplete instrument forms that are being stored or transported or are part of incoming or outgoing mail, or similar access.

(b) For the purpose of determining the rights and liabilities of a person who, in good faith, pays an instrument or takes it for value or for collection, if an employer entrusted an employee with responsibility with respect to the instrument and the employee or a person acting in concert with the employee makes a fraudulent indorsement of the instrument, the indorsement is effective as the indorsement of the person to whom the instrument is payable if it is made in the name of that person. If the person paying the instrument or taking it for value or for collection fails to exercise ordinary care

in paying or taking the instrument and that failure substantially contributes to loss resulting from the fraud, the person bearing the loss may recover from the person failing to exercise ordinary care to the extent the failure to exercise ordinary care contributed to the loss.

(c) Under subsection (b), an indorsement is made in the name of the person to whom an instrument is payable if (i) it is made in a name substantially similar to the name of that person or (ii) the instrument, whether or not indorsed, is deposited in a depositary bank to an account in a name substantially similar to the name of that person.

3-406. NEGLIGENCE CONTRIBUTING TO FORGED SIGNATURE OR ALTERATION OF INSTRUMENT.

(a) A person whose failure to exercise ordinary care substantially contributes to an alteration of an instrument or to the making of a forged signature on an instrument is precluded from asserting the alteration or the forgery against a person who, in good faith, pays the instrument or takes it for value or for collection.

(b) Under subsection (a), if the person asserting the preclusion fails to exercise ordinary care in paying or taking the instrument and that failure substantially contributes to loss, the loss is allocated between the person precluded and the person asserting the preclusion according to the extent to which the failure of each to exercise ordinary care contributed to the loss.

(c) Under subsection (a), the burden of proving failure to exercise ordinary care is on the person asserting the preclusion. Under subsection (b), the burden of proving failure to exercise ordinary care is on the person precluded.

3-407. ALTERATION.

(a) "**Alteration**" means (i) an unauthorized change in an instrument that purports to modify in any respect the obligation of a party, or (ii) an unauthorized addition of words or numbers or other change to an incomplete instrument relating to the obligation of a party.

(b) Except as provided in subsection (c), an alteration fraudulently made discharges a party whose obligation is affected by the alteration unless that party assents or is precluded from asserting the alteration. No other alteration discharges a party, and the instrument may be enforced according to its original terms.

(c) A payor bank or drawee paying a fraudulently altered instrument or a person taking it for value, in good faith and without notice of the alteration, may enforce rights with respect to the instrument (i) according to its original terms, or (ii) in the case of an incomplete instrument altered by unauthorized completion, according to its terms as completed.

3-408. DRAWEE NOT LIABLE ON UNACCEPTED DRAFT.

A check or other draft does not of itself operate as an assignment of funds in the hands of the drawee available for its payment, and the drawee is not liable on the instrument until the drawee accepts it.

3-409. ACCEPTANCE OF DRAFT; CERTIFIED CHECK.

(a) "**Acceptance**" means the drawee's signed agreement to pay a draft as presented. It must be written on the draft and may consist of the drawee's signature alone. Acceptance may be made at any time and becomes effective when notification pursuant to instructions is given or the accepted draft is delivered for the purpose of giving rights on the acceptance to any person.

(b) A draft may be accepted although it has not been signed by the drawer, is otherwise incomplete, is overdue, or has been dishonored.

(c) If a draft is payable at a fixed period after sight and the acceptor fails to date the acceptance, the holder may complete the acceptance by supplying a date in good faith.

(d) "**Certified check**" means a check accepted by the bank on which it is drawn. Acceptance may be made as stated in subsection (a) or by a writing on the check which indicates that the check is certified. The drawee of a check has no obligation to certify the check, and refusal to certify is not dishonor of the check.

3-410. ACCEPTANCE VARYING DRAFT.

(a) If the terms of a drawee's acceptance vary from the terms of the draft as presented, the holder may refuse the acceptance and treat the draft as dishonored. In that case, the drawee may cancel the acceptance.

(b) The terms of a draft are not varied by an acceptance to pay at a particular bank or place in the United States, unless the acceptance states that the draft is to be paid only at that bank or place.

(c) If the holder assents to an acceptance varying the terms of a draft, the obligation of each drawer and indorser that does not expressly assent to the acceptance is discharged.

3-411. REFUSAL TO PAY CASHIER'S CHECKS, TELLER'S CHECKS, AND CERTIFIED CHECKS.

(a) In this section, "**obligated bank**" means the acceptor of a certified check or the issuer of a cashier's check or teller's check bought from the issuer.

(b) If the obligated bank wrongfully (i) refuses to pay a cashier's check or certified check, (ii) stops payment of a teller's check, or (iii) refuses to pay a dishonored teller's check, the person asserting the right to enforce the check is entitled to compensation for expenses and loss of interest resulting from the nonpayment and may recover consequential damages if the obligated bank refuses to pay after receiving notice of particular circumstances giving rise to the damages.

(c) Expenses or consequential damages under subsection (b) are not recoverable if the refusal of the obligated bank to pay occurs because (i) the bank suspends payments, (ii) the obligated bank asserts a claim or defense of the bank that it has reasonable grounds to believe is available against the person entitled to enforce the instrument, (iii) the obligated bank has a reasonable doubt whether the person demanding payment is the person entitled to enforce the instrument, or (iv) payment is prohibited by law.

3-412. OBLIGATION OF ISSUER OF NOTE OR CASHIER'S CHECK.

The issuer of a note or cashier's check or other draft drawn on the drawer is obliged to pay the instrument (i) according to its terms at the time it was issued or, if not issued, at the time it first came into possession of a holder, or (ii) if the issuer signed an incomplete instrument, according to its terms when completed, to the extent stated in Sections 3-115 and 3-407. The obligation is owed to a person entitled to enforce the instrument or to an indorser who paid the instrument under Section 3-415.

3-413. OBLIGATION OF ACCEPTOR.

(a) The acceptor of a draft is obliged to pay the draft (i) according to its terms at the time it was accepted, even though the acceptance states that the draft is payable "as originally drawn" or equivalent terms, (ii) if the acceptance varies the terms of the draft, according to the terms of the draft as varied, or (iii) if the acceptance is of a draft that is an incomplete instrument, according to its terms when completed, to the extent stated in Sections 3-115 and 3-407. The obligation is owed to a person entitled to enforce the draft or to the drawer or an indorser who paid the draft under Section 3-414 or 3-415.

(b) If the certification of a check or other acceptance of a draft states the amount certified or accepted, the obligation of the acceptor is that amount. If (i) the certification or acceptance does not state an amount, (ii) the amount of the instrument is subsequently raised, and (iii) the instrument is then negotiated to a holder in due course, the obligation of the acceptor is the amount of the instrument at the time it was taken by the holder in due course.

3-414. OBLIGATION OF DRAWER.

(a) This section does not apply to cashier's checks or other drafts drawn on the drawer.

(b) If an unaccepted draft is dishonored, the drawer is obliged to pay the draft (i) according to its terms at the time it was issued or, if not issued, at the time it first came into possession of a holder, or (ii) if the drawer signed an incomplete instrument, according to its terms when completed, to the extent stated in Sections 3-115 and 3-407. The obligation is owed to a person entitled to enforce the draft or to an indorser who paid the draft under Section 3-415.

(c) If a draft is accepted by a bank, the drawer is discharged, regardless of when or by whom acceptance was obtained.

(d) If a draft is accepted and the acceptor is not a bank, the obligation of the drawer to pay the draft if the draft is dishonored by the acceptor is the same as the obligation of an indorser under Section 3-415(a) and (c).

(e) If a draft states that it is drawn "without recourse" or otherwise disclaims liability of the drawer to pay the draft, the drawer is not liable under subsection (b) to pay the draft if the draft is not a check. A disclaimer of the liability stated in subsection (b) is not effective if the draft is a check.

(f) If (i) a check is not presented for payment or given to a depositary bank for collection within 30 days after its date, (ii) the drawee suspends payments after expiration of the 30-day period without paying the check, and (iii) because of the suspension of payments, the drawer is deprived of funds maintained with the drawee to cover payment of the check, the drawer to the extent deprived of funds may discharge its obligation to pay the check by assigning to the person entitled to enforce the check the rights of the drawer against the drawee with respect to the funds.

3-415. OBLIGATION OF INDORSER.

(a) Subject to subsections (b), (c), and (d) and to Section 3-419(d), if an instrument is dishonored, an indorser is obliged to pay the amount due on the instrument (i) according to the terms of the instrument at the time it was indorsed, or (ii) if the indorser indorsed an incomplete instrument, according to its terms when completed, to the extent stated in Sections 3-115 and 3-407. The obligation of the indorser is owed to a person entitled to enforce the instrument or to a subsequent indorser who paid the instrument under this section.

(b) If an indorsement states that it is made "without recourse" or otherwise disclaims liability of the indorser, the indorser is not liable under subsection (a) to pay the instrument.

(c) If notice of dishonor of an instrument is required by Section 3-503 and notice of dishonor complying with that section is not given to an indorser, the liability of the indorser under subsection (a) is discharged.

(d) If a draft is accepted by a bank after an indorsement is made, the liability of the indorser under subsection (a) is discharged.

(e) If an indorser of a check is liable under subsection (a) and the check is not presented for payment, or given to a depositary bank for collection, within 30 days after the day the indorsement was made, the liability of the indorser under subsection (a) is discharged.

3-416. TRANSFER WARRANTIES.

(a) A person who transfers an instrument for consideration warrants to the transferee and, if the transfer is by indorsement, to any subsequent transferee that:

(1) the warrantor is a person entitled to enforce the instrument;

(2) all signatures on the instrument are authentic and authorized;

(3) the instrument has not been altered;

(4) the instrument is not subject to a defense or claim in recoupment of any party which can be asserted against the warrantor; and

(5) the warrantor has no knowledge of any insolvency proceeding commenced with respect to the maker or acceptor or, in the case of an unaccepted draft, the drawer; and

(6) with respect to a remotely-created consumer item, that the person on whose account the item is drawn authorized the issuance of the item in the amount for which the item is drawn.

(b) A person to whom the warranties under subsection (a) are made and who took the instrument in good faith may recover from the warrantor as damages for breach of warranty an amount equal to the loss suffered as a result of the breach, but not more than the amount of the instrument plus expenses and loss of interest incurred as a result of the breach.

(c) The warranties stated in subsection (a) cannot be disclaimed with respect to checks. Unless notice of a claim for breach of warranty is given to the warrantor within 30 days after the claimant has reason to know of the breach and the identity of the warrantor, the liability of the warrantor under subsection (b) is discharged to the extent of any loss caused by the delay in giving notice of the claim.

(d) A [cause of action] for breach of warranty under this section accrues when the claimant has reason to know of the breach.

3-417. PRESENTMENT WARRANTIES.

(a) If an unaccepted draft is presented to the drawee for payment or acceptance and the drawee pays or accepts the draft, (i) the person obtaining payment or acceptance, at the time of presentment, and (ii) a previous transferor of the draft, at the time of transfer, warrant to the drawee making payment or accepting the draft in good faith that:

(1) the warrantor is, or was, at the time the warrantor transferred the draft, a person entitled to enforce the draft or authorized to obtain payment or acceptance of the draft on behalf of a person entitled to enforce the draft;

(2) the draft has not been altered;

(3) the warrantor has no knowledge that the signature of the drawer of the draft is unauthorized; (4)

with respect to any remotely-created consumer item, that the person on whose account the item is drawn authorized the issuance of the item in the amount for which the item is drawn.

(b) A drawee making payment may recover from any warrantor damages for breach of warranty equal to the amount paid by the drawee less the amount the drawee received or is entitled to receive from the drawer because of the payment. In addition, the drawee is entitled to compensation for expenses and loss of interest resulting from the breach. The right of the drawee to recover damages under this subsection is not affected by any failure of the drawee to exercise ordinary care in making payment. If the drawee accepts the draft, breach of warranty is a defense to the obligation of the acceptor. If the acceptor makes payment with respect to the draft, the acceptor is entitled to recover from any warrantor for breach of warranty the amounts stated in this subsection.

(c) If a drawee asserts a claim for breach of warranty under subsection (a) based on an unauthorized indorsement of the draft or an alteration of the draft, the warrantor may defend by proving that the indorsement is effective under Section 3-404 or 3-405 or the drawer is precluded under Section 3-406 or 4-406 from asserting against the drawee the unauthorized indorsement or alteration.

(d) If (i) a dishonored draft is presented for payment to the drawer or an indorser or (ii) any other instrument is presented for payment to a party obliged to pay the instrument, and (iii) payment is received, the following rules apply:

(1) The person obtaining payment and a prior transferor of the instrument warrant to the person making payment in good faith that the warrantor is, or was, at the time the warrantor transferred the instrument, a person entitled to enforce the instrument or authorized to obtain payment on behalf of a person entitled to enforce the instrument.

(2) The person making payment may recover from any warrantor for breach of warranty an amount equal to the amount paid plus expenses and loss of interest resulting from the breach.

(e) The warranties stated in subsections (a) and (d) cannot be disclaimed with respect to checks. Unless notice of a claim for breach of warranty is given to the warrantor within 30 days after the claimant has reason to know of the breach and the identity of the warrantor, the liability of the warrantor under subsection (b) or (d) is discharged to the extent of any loss caused by the delay in giving notice of the claim.

(f) A [cause of action] for breach of warranty under this section accrues when the claimant has reason to know of the breach.

3-418. PAYMENT OR ACCEPTANCE BY MISTAKE.

(a) Except as provided in subsection (c), if the drawee of a draft pays or accepts the draft and the drawee acted on the mistaken belief that (i) payment of the draft had not been stopped pursuant to Section 4-403 or (ii) the signature of the drawer of the draft was authorized, the drawee may recover the amount of the draft from the person to whom or for whose benefit payment was made or, in the case of acceptance, may revoke the acceptance. Rights of the drawee under this subsection are not affected by failure of the drawee to exercise ordinary care in paying or accepting the draft.

(b) Except as provided in subsection (c), if an instrument has been paid or accepted by mistake and the case is not covered by subsection (a), the person paying or accepting may, to the extent permitted by the law governing mistake and restitution, (i) recover the payment from the person to whom or for whose benefit payment was made or (ii) in the case of acceptance, may revoke the acceptance.

(c) The remedies provided by subsection (a) or (b) may not be asserted against a person who took the instrument in good faith and for value or who in good faith changed position in reliance on the payment or acceptance. This subsection does not limit remedies provided by Section 3-417 or 4-407.

(d) Notwithstanding Section 4-215, if an instrument is paid or accepted by mistake and the payor or acceptor recovers payment or revokes acceptance under subsection (a) or (b), the instrument is deemed not to have been paid or accepted and is treated as dishonored, and the person from whom payment is recovered has rights as a person entitled to enforce the dishonored instrument.

3-419. INSTRUMENTS SIGNED FOR ACCOMMODATION.

(a) If an instrument is issued for value given for the benefit of a party to the instrument ("**accommodated party**") and another party to the instrument ("**accommodation party**") signs the instrument for the purpose of incurring liability on the instrument without being a direct beneficiary of the value given for the instrument, the instrument is signed by the accommodation party "**for accommodation**."

(b) An accommodation party may sign the instrument as maker, drawer, acceptor, or indorser and, subject to subsection (d), is obliged to pay the instrument in the capacity in which the accommodation party signs. The obligation of an accommodation party may be enforced notwithstanding any statute of frauds and whether or not the accommodation party receives consideration for the accommodation.

(c) A person signing an instrument is presumed to be an accommodation party and there is notice that the instrument is signed for accommodation if the signature is an anomalous indorsement or is accompanied by words indicating that the signer is acting as surety or guarantor with respect to the obligation of another party to the instrument. Except as provided in Section 3-605, the obligation of an accommodation party to pay the instrument is not affected by the fact that the person enforcing the obligation had notice when the instrument was taken by that person that the accommodation party signed the instrument for accommodation.

(d) If the signature of a party to an instrument is accompanied by words indicating unambiguously that the party is guaranteeing collection rather than payment of the obligation of another party to the instrument, the signer is obliged to pay the amount due on the instrument to a person entitled to enforce the instrument only if (i) execution of judgment against the other party has been returned unsatisfied, (ii) the other party is insolvent or in an insolvency proceeding, (iii) the other party cannot be served with process, or (iv) it is otherwise apparent that payment cannot be obtained from the other party.

(e) If the signature of a party to an instrument is accompanied by words indicating that the party guarantees payment or the signer signs the instrument as an accommodation party in some other manner that does not unambiguously indicate an intention to guarantee collection rather than payment, the signer is obliged to pay the amount due on the instrument to a person entitled to enforce the instrument in the same circumstances as the accommodated party would be obliged, without prior resort to the accommodated party by the person entitled to enforce the instrument.

(f) An accommodation party who pays the instrument is entitled to reimbursement from the accommodated party and is entitled to enforce the instrument against the accommodated party. In proper circumstances, an accommodation party may obtain relief that requires the accommodated party to perform its obligations on the instrument. An accommodated party that pays the instrument has no right of recourse against, and is not entitled to contribution from, an accommodation party.

3-420. CONVERSION OF INSTRUMENT.

(a) The law applicable to conversion of personal property applies to instruments. An instrument is also converted if it is taken by transfer, other than a negotiation, from a person not entitled to enforce the instrument or a bank makes or obtains payment with respect to the instrument for a person not entitled to enforce the instrument or receive payment. An action for conversion of an instrument may not be brought by (i) the issuer or acceptor of the instrument or (ii) a payee or indorsee who did not receive delivery of the instrument either directly or through delivery to an agent or a co-payee.

(b) In an action under subsection (a), the measure of liability is presumed to be the amount payable on the instrument, but recovery may not exceed the amount of the plaintiff's interest in the instrument.

(c) A representative, other than a depositary bank, who has in good faith dealt with an instrument or its proceeds on behalf of one who was not the person entitled to enforce the instrument is not liable in conversion to that person beyond the amount of any proceeds that it has not paid out.

PART 5. DISHONOR [Table of Contents]

3-501. PRESENTMENT.

(a) "**Presentment**" means a demand made by or on behalf of a person entitled to enforce an instrument (i) to pay the instrument made to the drawee or a party obliged to pay the instrument or, in the case of a note or accepted draft payable at a bank, to the bank, or (ii) to accept a draft made to the drawee.

(b) The following rules are subject to Article 4, agreement of the parties, and clearing-house rules and the like:

(1) Presentment may be made at the place of payment of the instrument and must be made at the place of payment if the instrument is payable at a bank in the United States; may be made by any commercially reasonable means, including an oral, written, or electronic communication; is effective when the demand for payment or acceptance is received by the person to whom presentment is made; and is effective if made to any one of two or more makers, acceptors, drawees, or other payors.

(2) Upon demand of the person to whom presentment is made, the person making presentment must (i) exhibit the instrument, (ii) give reasonable identification and, if presentment is made on behalf of another person, reasonable evidence of authority to do so, and (iii) sign a receipt on the instrument for any payment made or surrender the instrument if full payment is made.

(3) Without dishonoring the instrument, the party to whom presentment is made may (i) return the instrument for lack of a necessary indorsement, or (ii) refuse payment or acceptance for

failure of the presentment to comply with the terms of the instrument, an agreement of the parties, or other applicable law or rule.

(4) The party to whom presentment is made may treat presentment as occurring on the next business day after the day of presentment if the party to whom presentment is made has established a cut-off hour not earlier than 2 p.m. for the receipt and processing of instruments presented for payment or acceptance and presentment is made after the cut-off hour.

3-502. DISHONOR.

(a) Dishonor of a note is governed by the following rules:

(1) If the note is payable on demand, the note is dishonored if presentment is duly made to the maker and the note is not paid on the day of presentment.

(2) If the note is not payable on demand and is payable at or through a bank or the terms of the note require presentment, the note is dishonored if presentment is duly made and the note is not paid on the day it becomes payable or the day of presentment, whichever is later.

(3) If the note is not payable on demand and paragraph (2) does not apply, the note is dishonored if it is not paid on the day it becomes payable.

(b) Dishonor of an unaccepted draft other than a documentary draft is governed by the following rules:

(1) If a check is duly presented for payment to the payor bank otherwise than for immediate payment over the counter, the check is dishonored if the payor bank makes timely return of the check or sends timely notice of dishonor or nonpayment under Section 4-301 or 4-302, or becomes accountable for the amount of the check under Section 4-302.

(2) If a draft is payable on demand and paragraph (1) does not apply, the draft is dishonored if presentment for payment is duly made to the drawee and the draft is not paid on the day of presentment.

(3) If a draft is payable on a date stated in the draft, the draft is dishonored if (i) presentment for payment is duly made to the drawee and payment is not made on the day the draft becomes payable or the day of presentment, whichever is later, or (ii) presentment for acceptance is duly made before the day the draft becomes payable and the draft is not accepted on the day of presentment.

(4) If a draft is payable on elapse of a period of time after sight or acceptance, the draft is dishonored if presentment for acceptance is duly made and the draft is not accepted on the day of presentment.

(c) Dishonor of an unaccepted documentary draft occurs according to the rules stated in subsection (b)(2), (3), and (4), except that payment or acceptance may be delayed without dishonor until no later than the close of the third business day of the drawee following the day on which payment or acceptance is required by those paragraphs.

(d) Dishonor of an accepted draft is governed by the following rules:

(1) If the draft is payable on demand, the draft is dishonored if presentment for payment is duly made to the acceptor and the draft is not paid on the day of presentment.

(2) If the draft is not payable on demand, the draft is dishonored if presentment for payment is duly made to the acceptor and payment is not made on the day it becomes payable or the day of presentment, whichever is later.

(e) In any case in which presentment is otherwise required for dishonor under this section and presentment is excused under Section 3-504, dishonor occurs without presentment if the instrument is not duly accepted or paid.

(f) If a draft is dishonored because timely acceptance of the draft was not made and the person entitled to demand acceptance consents to a late acceptance, from the time of acceptance the draft is treated as never having been dishonored.

3-503. NOTICE OF DISHONOR.

(a) The obligation of an indorser stated in Section 3-415(a) and the obligation of a drawer stated in Section 3-414(d) may not be enforced unless (i) the indorser or drawer is given notice of dishonor of the instrument complying with this section or (ii) notice of dishonor is excused under Section 3-504(b).

(b) Notice of dishonor may be given by any person; may be given by any commercially reasonable means, including an oral, written, or electronic communication; and is sufficient if it reasonably

identifies the instrument and indicates that the instrument has been dishonored or has not been paid or accepted. Return of an instrument given to a bank for collection is sufficient notice of dishonor.

(c) Subject to Section 3-504(c), with respect to an instrument taken for collection by a collecting bank, notice of dishonor must be given (i) by the bank before midnight of the next banking day following the banking day on which the bank receives notice of dishonor of the instrument, or (ii) by any other person within 30 days following the day on which the person receives notice of dishonor. With respect to any other instrument, notice of dishonor must be given within 30 days following the day on which dishonor occurs.

3-504. EXCUSED PRESENTMENT AND NOTICE OF DISHONOR.

(a) Presentment for payment or acceptance of an instrument is excused if (i) the person entitled to present the instrument cannot with reasonable diligence make presentment, (ii) the maker or acceptor has repudiated an obligation to pay the instrument or is dead or in insolvency proceedings, (iii) by the terms of the instrument presentment is not necessary to enforce the obligation of indorsers or the drawer, (iv) the drawer or indorser whose obligation is being enforced has waived presentment or otherwise has no reason to expect or right to require that the instrument be paid or accepted, or (v) the drawer instructed the drawee not to pay or accept the draft or the drawee was not obligated to the drawer to pay the draft.

(b) Notice of dishonor is excused if (i) by the terms of the instrument notice of dishonor is not necessary to enforce the obligation of a party to pay the instrument, or (ii) the party whose obligation is being enforced waived notice of dishonor. A waiver of presentment is also a waiver of notice of dishonor.

(c) Delay in giving notice of dishonor is excused if the delay was caused by circumstances beyond the control of the person giving the notice and the person giving the notice exercised reasonable diligence after the cause of the delay ceased to operate.

3-505. EVIDENCE OF DISHONOR.

(a) The following are admissible as evidence and create a presumption of dishonor and of any notice of dishonor stated:

(1) a document regular in form as provided in subsection (b) which purports to be a protest;

(2) a purported stamp or writing of the drawee, payor bank, or presenting bank on or accompanying the instrument stating that acceptance or payment has been refused unless reasons for the refusal are stated and the reasons are not consistent with dishonor;

(3) a book or record of the drawee, payor bank, or collecting bank, kept in the usual course of business which shows dishonor, even if there is no evidence of who made the entry.

(b) A protest is a certificate of dishonor made by a United States consul or vice consul, or a notary public or other person authorized to administer oaths by the law of the place where dishonor occurs. It may be made upon information satisfactory to that person. The protest must identify the instrument and certify either that presentment has been made or, if not made, the reason why it was not made, and that the instrument has been dishonored by nonacceptance or nonpayment. The protest may also certify that notice of dishonor has been given to some or all parties.

PART 6. DISCHARGE AND PAYMENT [Table of Contents]

3-601. DISCHARGE AND EFFECT OF DISCHARGE.

(a) The obligation of a party to pay the instrument is discharged as stated in this Article or by an act or agreement with the party which would discharge an obligation to pay money under a simple contract.

(b) Discharge of the obligation of a party is not effective against a person acquiring rights of a holder in due course of the instrument without notice of the discharge.

3-602. PAYMENT.

(a) Subject to subsection (b), an instrument is paid to the extent payment is made (i) by or on behalf of a party obliged to pay the instrument, and (ii) to a person entitled to enforce the instrument. To the extent of the payment, the obligation of the party obliged to pay the instrument is discharged even though payment is made with knowledge of a claim to the instrument under Section 3-306 by another person.

(b) Subject to subsection (e) a note is paid to the extent payment is made by or on behalf of a party obliged to pay the note to a person that formerly was entitled to enforce the note only if at the time of the payment the party obliged to pay has not received adequate notification that the note has been transferred and that payment is to be made to the transferee. A notification is adequate only if it is

signed by the transferor or the transferee; reasonably identifies the transferred note; and provides an address at which payments subsequently can be made. Upon request, a transferee shall seasonably furnish reasonable proof that the note has been transferred. Unless the transferee complies with the request, a payment to the person that formerly was entitled to enforce the note is effective for purposes of subsection (c) even if the party obliged to pay the note has received a notification under this paragraph.

(c) Subject to subsection (e), to the extent of a payment under subsections (a) and (b), the obligation of the party obliged to pay the instrument is discharged even though payment is made with knowledge of a claim to the instrument under Section 3-306 by another person.

(d) Subject to subsection (e), a transferee, or any party that has acquired rights in the instrument directly or indirectly from a transferee, including any such party that has rights as a holder in due course, is deemed to have notice of any payment that is made under subsection (b) after the date that the note is transferred to the transferee but before the party obliged to pay the note receives adequate notification of the transfer.

(e) The obligation of a party to pay the instrument is not discharged under subsections (a) through (d) if:

(1) a claim to the instrument under Section 3-306 is enforceable against the party receiving payment and (i) payment is made with knowledge by the payor that payment is prohibited by injunction or similar process of a court of competent jurisdiction, or (ii) in the case of an instrument other than a cashier's check, teller's check, or certified check, the party making payment accepted, from the person having a claim to the instrument, indemnity against loss resulting from refusal to pay the person entitled to enforce the instrument; or

(2) the person making payment knows that the instrument is a stolen instrument and pays a person it knows is in wrongful possession of the instrument.

(f) As used in this section, "signed," with respect to a record that is not a writing, includes the attachment to or logical association with the record of an electronic symbol, sound, or process to or with the record with the present intent to adopt or accept the record.

3-603. TENDER OF PAYMENT.

(a) If tender of payment of an obligation to pay an instrument is made to a person entitled to enforce the instrument, the effect of tender is governed by principles of law applicable to tender of payment under a simple contract.

(b) If tender of payment of an obligation to pay an instrument is made to a person entitled to enforce the instrument and the tender is refused, there is discharge, to the extent of the amount of the tender, of the obligation of an indorser or accommodation party having a right of recourse with respect to the obligation to which the tender relates.

(c) If tender of payment of an amount due on an instrument is made to a person entitled to enforce the instrument, the obligation of the obligor to pay interest after the due date on the amount tendered is discharged. If presentment is required with respect to an instrument and the obligor is able and ready to pay on the due date at every place of payment stated in the instrument, the obligor is deemed to have made tender of payment on the due date to the person entitled to enforce the instrument.

3-604. DISCHARGE BY CANCELLATION OR RENUNCIATION.

(a) A person entitled to enforce an instrument, with or without consideration, may discharge the obligation of a party to pay the instrument (i) by an intentional voluntary act, such as surrender of the instrument to the party, destruction, mutilation, or cancellation of the instrument, cancellation or striking out of the party's signature, or the addition of words to the instrument indicating discharge, or (ii) by agreeing not to sue or otherwise renouncing rights against the party by a signed record.

(b) Cancellation or striking out of an indorsement pursuant to subsection (a) does not affect the status and rights of a party derived from the indorsement.

(c) As used in this section, "signed," with respect to a record that is not a writing, includes the attachment to or logical association with the record of an electronic symbol, sound, or process to or with the record with the present intent to adopt or accept the record.

3-605. DISCHARGE OF SECONDARY OBLIGORS.

(a) If a person entitled to enforce an instrument releases the obligation of a principal obligor in whole or in part, and another party to the instrument is a secondary obligor with respect to the obligation of that principal obligor, the following rules apply:

(1) Any obligations of the principal obligor to the secondary obligor with respect to any previous payment by the secondary obligor are not affected. Unless the terms of the release preserve the secondary obligor's recourse, the principal obligor is discharged, to the extent of the release, from any other duties to the secondary obligor under this article.

(2) Unless the terms of the release provide that the person entitled to enforce the instrument retains the right to enforce the instrument against the secondary obligor, the secondary obligor is discharged to the same extent as the principal obligor from any unperformed portion of its obligation on the instrument. If the instrument is a check and the obligation of the secondary obligor is based on an indorsement of the check, the secondary obligor is discharged without regard to the language or circumstances of the discharge or other release.

(3) If the secondary obligor is not discharged under paragraph (2), the secondary obligor is discharged to the extent of the value of the consideration for the release, and to the extent that the release would otherwise cause the secondary obligor a loss.

(b) If a person entitled to enforce an instrument grants a principal obligor an extension of the time at which one or more payments are due on the instrument and another party to the instrument is a secondary obligor with respect to the obligation of that principal obligor, the following rules apply:

(1) Any obligations of the principal obligor to the secondary obligor with respect to any previous payment by the secondary obligor are not affected. Unless the terms of the extension preserve the secondary obligor's recourse, the extension correspondingly extends the time for performance of any other duties owed to the secondary obligor by the principal obligor under this article.

(2) The secondary obligor is discharged to the extent that the extension would otherwise cause the secondary obligor a loss.

(3) To the extent that the secondary obligor is not discharged under paragraph (2), the secondary obligor may perform its obligations to a person entitled to enforce the instrument as if the time for payment had not been extended or, unless the terms of the extension provide that the person entitled to enforce the instrument retains the right to enforce the instrument against the secondary obligor as if the time for payment had not been extended, treat the time for performance of its obligations as having been extended correspondingly.

(c) If a person entitled to enforce an instrument agrees, with or without consideration, to a modification of the obligation of a principal obligor other than a complete or partial release or an extension of the due date and another party to the instrument is a secondary obligor with respect to the obligation of that principal obligor, the following rules apply:

(1) Any obligations of the principal obligor to the secondary obligor with respect to any previous payment by the secondary obligor are not affected. The modification correspondingly modifies any other duties owed to the secondary obligor by the principal obligor under this article.

(2) The secondary obligor is discharged from any unperformed portion of its obligation to the extent that the modification would otherwise cause the secondary obligor a loss.

(3) To the extent that the secondary obligor is not discharged under paragraph (2), the secondary obligor may satisfy its obligation on the instrument as if the modification had not occurred, or treat its obligation on the instrument as having been modified correspondingly.

(d) If the obligation of a principal obligor is secured by an interest in collateral, another party to the instrument is a secondary obligor with respect to that obligation, and a person entitled to enforce the instrument impairs the value of the interest in collateral, the obligation of the secondary obligor is discharged to the extent of the impairment. The value of an interest in collateral is impaired to the extent the value of the interest is reduced to an amount less than the amount of the recourse of the secondary obligor, or the reduction in value of the interest causes an increase in the amount by which the amount of the recourse exceeds the value of the interest.

For purposes of this subsection, impairing the value of an interest in collateral includes failure to obtain or maintain perfection or recordation of the interest in collateral, release of collateral without substitution of collateral of equal value or equivalent reduction of the underlying obligation, failure to perform a duty to preserve the value of collateral owed, under Article 9 or other law, to a debtor or other person secondarily liable, and failure to comply with applicable law in disposing of or otherwise enforcing the interest in collateral.

(e) A secondary obligor is not discharged under subsection (a)(3), (b), (c), or (d) unless the person entitled to enforce the instrument knows that the person is a secondary obligor or has notice under Section 3-419(c) that the instrument was signed for accommodation.

(f) A secondary obligor is not discharged under this section if the secondary obligor consents to the event or conduct that is the basis of the discharge, or the instrument or a separate agreement of the party provides for waiver of discharge under this section specifically or by general language indicating that parties waive defenses based on suretyship or impairment of collateral. Unless the circumstances indicate otherwise, consent by the principal obligor to an act that would lead to a discharge under this section constitutes consent to that act by the secondary obligor if the secondary obligor controls the principal obligor or deals with the person entitled to enforce the instrument on behalf of the principal obligor.

(g) A release or extension preserves a secondary obligor's recourse if the terms of the release or extension provide that the person entitled to enforce the instrument retains the right to enforce the instrument against the secondary obligor; and the recourse of the secondary obligor continues as though the release or extension had not been granted.

(h) Except as otherwise provided in subsection (i), a secondary obligor asserting discharge under this section has the burden of persuasion both with respect to the occurrence of the acts alleged to harm the secondary obligor and loss or prejudice caused by those acts.

(i) If the secondary obligor demonstrates prejudice caused by an impairment of its recourse, and the circumstances of the case indicate that the amount of loss is not reasonably susceptible of calculation or requires proof of facts that are not ascertainable, it is presumed that the act impairing recourse caused a loss or impairment equal to the liability of the secondary obligor on the instrument. In that event, the burden of persuasion as to any lesser amount of the loss is on the person entitled to enforce the instrument.

ARTICLE 4 - BANK DEPOSITS AND COLLECTIONS

PART 1. GENERAL PROVISIONS AND DEFINITIONS [Table of Contents]

4-101. SHORT TITLE.

This Article may be cited as Uniform Commercial Code -- Bank Deposits and Collections.

4-102. APPLICABILITY.

(a) To the extent that items within this Article are also within Articles 3 and 8, they are subject to those Articles. If there is conflict, this Article governs Article 3, but Article 8 governs this Article.

(b) The liability of a bank for action or non-action with respect to an item handled by it for purposes of presentment, payment, or collection is governed by the law of the place where the bank is located. In the case of action or non-action by or at a branch or separate office of a bank, its liability is governed by the law of the place where the branch or separate office is located.

4-103. VARIATION BY AGREEMENT; MEASURE OF DAMAGES; ACTION CONSTITUTING ORDINARY CARE.

(a) The effect of the provisions of this Article may be varied by agreement , but the parties to the agreement cannot disclaim a bank's responsibility for its lack of good faith or failure to exercise ordinary care or limit the measure of damages for the lack or failure. However, the parties may determine by agreement the standards by which the bank's responsibility is to be measured if those standards are not manifestly unreasonable.

(b) Federal Reserve regulations and operating circulars, clearing-house rules, and the like have the effect of agreements under subsection (a), whether or not specifically assented to by all parties interested in items handled.

(c) Action or non-action approved by this Article or pursuant to Federal Reserve regulations or operating circulars is the exercise of ordinary care and, in the absence of special instructions, action or non-action consistent with clearing-house rules and the like or with a general banking usage not disapproved by this Article, is prima facie the exercise of ordinary care.

(d) The specification or approval of certain procedures by this Article is not disapproval of other procedures that may be reasonable under the circumstances.

(e) The measure of damages for failure to exercise ordinary care in handling an item is the amount of the item reduced by an amount that could not have been realized by the exercise of ordinary care. If there is also bad faith it includes any other damages the party suffered as a proximate consequence.

4-104. DEFINITIONS AND INDEX OF DEFINITIONS.

(a) In this Article, unless the context otherwise requires:

(1) "**Account**" means any deposit or credit account with a bank , including a demand, time, savings, passbook, share draft, or like account, other than an account evidenced by a certificate of deposit;

(2) "**Afternoon**" means the period of a day between noon and midnight;

(3) "**Banking day**" means the part of a day on which a bank is open to the public for carrying on substantially all of its banking functions;

(4) "**Clearing house**" means an association of banks or other payors regularly clearing items;

(5) "**Customer**" means a person having an account with a bank or for whom a bank has agreed to collect items, including a bank that maintains an account at another bank;

(6) "**Documentary draft**" means a draft to be presented for acceptance or payment if specified documents, certificated securities (Section 8-102) or instructions for uncertificated securities (Section 8-102), or other certificates, statements, or the like are to be received by the drawee or other payor before acceptance or payment of the draft;

(7) "**Draft**" means a draft as defined in Section 3-104 or an item, other than an instrument, that is an order.

(8) "**Drawee**" means a person ordered in a draft to make payment.

(9) "**Item**" means an instrument or a promise or order to pay money handled by a bank for collection or payment. The term does not include a payment order governed by Article 4A or a credit or debit card slip;

(10) "**Midnight deadline**" with respect to a bank is midnight on its next banking day following the banking day on which it receives the relevant item or notice or from which the time for taking action commences to run, whichever is later;

(11) "**Settle**" means to pay in cash, by clearing-house settlement, in a charge or credit or by remittance, or otherwise as agreed. A settlement may be either provisional or final.

(12) "**Suspends payments**" with respect to a bank means that it has been closed by order of the supervisory authorities, that a public officer has been appointed to take it over, or that it ceases or refuses to make payments in the ordinary course of business.

(b) Other definitions applying to this Article and the sections in which they appear are:

"**Agreement for electronic presentment**"	Section 4-110
"**Collecting bank**"	Section 4-105
"**Depositary bank**"	Section 4-105
"**Intermediary bank**"	Section 4-105
"**Payor bank**"	Section 4-105
"**Presenting bank**"	Section 4-105
"**Presentment notice**"	Section 4-110

(c) "Control" as provided in Section 7-106 and the following definitions in other Articles apply to this Article:

"**Acceptance**"	Section 3-409
"**Alteration**"	Section 3-407
"**Cashier's check**"	Section 3-104
"**Certificate of deposit**"	Section 3-104
"**Certified check**"	Section 3-409
"**Check**"	Section 3-104
"**Holder in due course**"	Section 3-302
"**Instrument**"	Section 3-104
"**Notice of dishonor**"	Section 3-503
"**Order**"	Section 3-103
"**Ordinary care**"	Section 3-103

"**Person entitled to enforce**"	Section 3-301
"**Presentment**"	Section 3-501
"**Promise**"	Section 3-103
"**Prove**"	Section 3-103
"**Record**"	Section 3-103.
"**Remotely-Created consumer item**"	Section 3-103.
"**Teller's check**"	Section 3-104
"**Unauthorized signature**"	Section 3-403

(d) In addition, Article 1 contains general definitions and principles of construction and interpretation applicable throughout this Article.

4-105. "BANK"; "DEPOSITARY BANK"; "PAYOR BANK"; "INTERMEDIARY BANK"; "COLLECTING BANK"; "PRESENTING BANK".

In this Article :

(1) "**Bank**" means a person engaged in the business of banking, including a savings bank, savings and loan association, credit union, or trust company.

(2) "**Depositary bank**" means the first bank to take an item even though it is also the payor bank, unless the item is presented for immediate payment over the counter;

(3) "**Payor bank**" means a bank that is the drawee of a draft;

(4) "**Intermediary bank**" means a bank to which an item is transferred in course of collection except the depositary or payor bank;

(5) "**Collecting bank**" means a bank handling an item for collection except the payor bank;

(6) "**Presenting bank**" means a bank presenting an item except a payor bank.

4-106. PAYABLE THROUGH OR PAYABLE AT BANK; COLLECTING BANK.

(a) If an item states that it is "payable through" a bank identified in the item, (i) the item designates the bank as a collecting bank and does not by itself authorize the bank to pay the item, and (ii) the item may be presented for payment only by or through the bank.

Alternative A

(b) If an item states that it is "payable at" a bank identified in the item, the item is equivalent to a draft drawn on the bank.

Alternative B

(b) If an item states that it is "payable at" a bank identified in the item, (i) the item designates the bank as a collecting bank and does not by itself authorize the bank to pay the item, and (ii) the item may be presented for payment only by or through the bank.

(c) If a draft names a nonbank drawee and it is unclear whether a bank named in the draft is a co-drawee or a collecting bank, the bank is a collecting bank.

4-107. SEPARATE OFFICE OF BANK.

A branch or separate office of a bank is a separate bank for the purpose of computing the time within which and determining the place at or to which action may be taken or notice or orders must be given under this Article and under Article 3.

4-108. TIME OF RECEIPT OF ITEMS.

(a) For the purpose of allowing time to process items, prove balances, and make the necessary entries on its books to determine its position for the day, a bank may fix an afternoon hour of 2 P.M. or later as a cutoff hour for the handling of money and items and the making of entries on its books.

(b) An item or deposit of money received on any day after a cutoff hour so fixed or after the close of the banking day may be treated as being received at the opening of the next banking day.

4-109. DELAYS.

(a) Unless otherwise instructed, a collecting bank in a good faith effort to secure payment of a specific item drawn on a payor other than a bank, and with or without the approval of any person involved, may waive, modify, or extend time limits imposed or permitted by this [Act] for a period not

exceeding two additional banking days without discharge of drawers or indorsers or liability to its transferor or a prior party.

(b) Delay by a collecting bank or payor bank beyond time limits prescribed or permitted by this [Act] or by instructions is excused if (i) the delay is caused by interruption of communication or computer facilities, suspension of payments by another bank, war, emergency conditions, failure of equipment, or other circumstances beyond the control of the bank , and (ii) the bank exercises such diligence as the circumstances require.

4-110. ELECTRONIC PRESENTMENT.

(a) "**Agreement for electronic presentment**" means an agreement, clearing-house rule, or Federal Reserve regulation or operating circular, providing that presentment of an item may be made by transmission of an image of an item or information describing the item ("presentment notice") rather than delivery of the item itself. The agreement may provide for procedures governing retention, presentment, payment, dishonor, and other matters concerning items subject to the agreement.

(b) Presentment of an item pursuant to an agreement for presentment is made when the presentment notice is received.

(c) If presentment is made by presentment notice, a reference to "item" or "check" in this Article means the presentment notice unless the context otherwise indicates.

4-111. STATUTE OF LIMITATIONS.

An action to enforce an obligation, duty, or right arising under this Article must be commenced within three years after the [cause of action] accrues.

PART 2. COLLECTION OF ITEMS: DEPOSITARY AND COLLECTING BANKS [Table of Contents]

4-201. STATUS OF COLLECTING BANK AS AGENT AND PROVISIONAL STATUS OF CREDITS; APPLICABILITY OF ARTICLE; ITEM INDORSED "PAY ANY BANK".

(a) Unless a contrary intent clearly appears and before the time that a settlement given by a collecting bank for an item is or becomes final, the bank, with respect to the item, is an agent or sub-agent of the owner of the item and any settlement given for the item is provisional. This provision applies regardless of the form of indorsement or lack of indorsement and even though credit given for the item is subject to immediate withdrawal as of right.

It is in fact withdrawn; but the continuance of ownership of an item by its owner and any rights of the owner to proceeds of the item are subject to rights of a collecting bank, such as those resulting from outstanding advances on the item and rights of recoupment or setoff. If an item is handled by banks for purposes of presentment, payment , collection, or return, the relevant provisions of this Article apply even though action of the parties clearly establishes that a particular bank has purchased the item and is the owner of it.

(b) After an item has been indorsed with the words "pay any bank" or the like, only a bank may acquire the rights of a holder until the item has been:

(1) returned to the customer initiating collection; or

(2) specially indorsed by a bank to a person who is not a bank.

4-202. RESPONSIBILITY FOR COLLECTION OR RETURN; WHEN ACTION TIMELY.

(a) A collecting bank must exercise ordinary care in:

(1) presenting an item or sending it for presentment;

(2) sending notice of dishonor or nonpayment or returning an item other than a documentary draft to the bank's transferor after learning that the item has not been paid or accepted, as the case may be;

(3) settling for an item when the bank receives final settlement; and

(4) notifying its transferor of any loss or delay in transit within a reasonable time after discovery thereof.

(b) A collecting bank exercises ordinary care under subsection (a) by taking proper action before its midnight deadline following receipt of an item, notice, or settlement. Taking proper action within a reasonably longer time may constitute the exercise of ordinary care, but the bank has the burden of establishing timeliness.

(c) Subject to subsection (a)(1), a bank is not liable for the insolvency, neglect, misconduct, mistake, or default of another bank or person or for loss or destruction of an item in the possession of others or in transit .

4-203. EFFECT OF INSTRUCTIONS.

Subject to Article 3 concerning conversion of instruments (Section 3-420) and restrictive indorsements (Section 3-206), only a collecting bank's transferor can give instructions that affect the bank or constitute notice to it, and a collecting bank is not liable to prior parties for any action taken pursuant to the instructions or in accordance with any agreement with its transferor.

4-204. METHODS OF SENDING AND PRESENTING; SENDING DIRECTLY TO PAYOR BANK.

(a) A collecting bank shall send items by a reasonably prompt method, taking into consideration relevant instructions, the nature of the item, the number of those items on hand, the cost of collection involved, and the method generally used by it or others to present those items.

(b) A collecting bank may send:

(1) an item directly to the payor bank;

(2) an item to a nonbank payor if authorized by its transferor; and

(3) an item other than documentary drafts to a nonbank payor, if authorized by Federal Reserve regulation or operating circular, clearing-house rule, or the like.

(c) Presentment may be made by a presenting bank at a place where the payor bank or other payor has requested that presentment be made.

4-205. DEPOSITARY BANK HOLDER OF UNINDORSED ITEM.

If a customer delivers an item to a depositary bank for collection:

(1) the depositary bank becomes a holder of the item at the time it receives the item for collection if the customer at the time of delivery was a holder of the item, whether or not the customer indorses the item, and, if the bank satisfies the other requirements of Section 3-302, it is a holder in due course; and

(2) the depositary bank warrants to collecting banks, the payor bank or other payor, and the drawer that the amount of the item was paid to the customer or deposited to the customer's account.

4-206. TRANSFER BETWEEN BANKS.

Any agreed method that identifies the transferor bank is sufficient for the item's further transfer to another bank.

4-207. TRANSFER WARRANTIES.

(a) A customer or collecting bank that transfers an item and receives a settlement or other consideration warrants to the transferee and to any subsequent collecting bank that:

(1) the warrantor is a person entitled to enforce the item;

(2) all signatures on the item are authentic and authorized;

(3) the item has not been altered;

(4) the item is not subject to a defense or claim in recoupment (Section 3-305(a)) of any party that can be asserted against the warrantor; and

(5) the warrantor has no knowledge of any insolvency proceeding commenced with respect to the maker or acceptor or, in the case of an unaccepted draft, the drawer; and

(6) with respect to any remotely-created consumer item, that the person on whose account the item is drawn authorized the issuance of the item in the amount for which the item is drawn.

(b) If an item is dishonored, a customer or collecting bank transferring the item and receiving settlement or other consideration is obliged to pay the amount due on the item (i) according to the terms of the item at the time it was transferred, or (ii) if the transfer was of an incomplete item, according to its terms when completed as stated in Sections 3-115 and 3-407. The obligation of a transferor is owed to the transferee and to any subsequent collecting bank that takes the item in good faith. A transferor cannot disclaim its obligation under this subsection by an indorsement stating that it is made "without recourse" or otherwise disclaiming liability.

(c) A person to whom the warranties under subsection (a) are made and who took the item in good faith may recover from the warrantor as damages for breach of warranty an amount equal to the loss

suffered as a result of the breach, but not more than the amount of the item plus expenses and loss of interest incurred as a result of the breach.

(d) The warranties stated in subsection (a) cannot be disclaimed with respect to checks. Unless notice of a claim for breach of warranty is given to the warrantor within 30 days after the claimant has reason to know of the breach and the identity of the warrantor, the warrantor is discharged to the extent of any loss caused by the delay in giving notice of the claim.

(e) A cause of action for breach of warranty under this section accrues when the claimant has reason to know of the breach.

4-208. PRESENTMENT WARRANTIES.

(a) If an unaccepted draft is presented to the drawee for payment or acceptance and the drawee pays or accepts the draft, (i) the person obtaining payment or acceptance, at the time of presentment, and (ii) a previous transferor of the draft, at the time of transfer, warrant to the drawee that pays or accepts the draft in good faith that:

(1) the warrantor is, or was, at the time the warrantor transferred the draft, a person entitled to enforce the draft or authorized to obtain payment or acceptance of the draft on behalf of a person entitled to enforce the draft;

(2) the draft has not been altered; and

(3) the warrantor has no knowledge that the signature of the purported drawer of the draft is unauthorized; and

(4) with respect to any remotely-created consumer item, that the person on whose account the item is drawn authorized the issuance of the item in the amount for which the item is drawn.

(b) A drawee making payment may recover from a warrantor damages for breach of warranty equal to the amount paid by the drawee less the amount the drawee received or is entitled to receive from the drawer because of the payment. In addition, the drawee is entitled to compensation for expenses and loss of interest resulting from the breach. The right of the drawee to recover damages under this subsection is not affected by any failure of the drawee to exercise ordinary care in making payment. If the drawee accepts the draft (i) breach of warranty is a defense to the obligation of the acceptor, and (ii) if the acceptor makes payment with respect to the draft, the acceptor is entitled to recover from a warrantor for breach of warranty the amounts stated in this subsection.

(c) If a drawee asserts a claim for breach of warranty under subsection (a) based on an unauthorized indorsement of the draft or an alteration of the draft, the warrantor may defend by proving that the indorsement is effective under Section 3-404 or 3-405 or the drawer is precluded under Section 3-406 or 4-406 from asserting against the drawee the unauthorized indorsement or alteration.

(d) If (i) a dishonored draft is presented for payment to the drawer or an indorser or (ii) any other item is presented for payment to a party obliged to pay the item, and the item is paid, the person obtaining payment and a prior transferor of the item warrant to the person making payment in good faith that the warrantor is, or was, at the time the warrantor transferred the item, a person entitled to enforce the item or authorized to obtain payment on behalf of a person entitled to enforce the item. The person making payment may recover from any warrantor for breach of warranty an amount equal to the amount paid plus expenses and loss of interest resulting from the breach.

(e) The warranties stated in subsections (a) and (d) cannot be disclaimed with respect to checks. Unless notice of a claim for breach of warranty is given to the warrantor within 30 days after the claimant has reason to know of the breach and the identity of the warrantor, the warrantor is discharged to the extent of any loss caused by the delay in giving notice of the claim.

(f) A cause of action for breach of warranty under this section accrues when the claimant has reason to know of the breach.

4-209. ENCODING AND RETENTION WARRANTIES.

(a) A person who encodes information on or with respect to an item after issue warrants to any subsequent collecting bank and to the payor bank or other payor that the information is correctly encoded. If the customer of a depositary bank encodes, that bank also makes the warranty.

(b) A person who undertakes to retain an item pursuant to an agreement for electronic presentment warrants to any subsequent collecting bank and to the payor bank or other payor that retention and presentment of the item comply with the agreement. If a customer of a depositary bank undertakes to retain an item, that bank also makes this warranty.

(c) A person to whom warranties are made under this section and who took the item in good faith may recover from the warrantor as damages for breach of warranty an amount equal to the loss

suffered as a result of the breach, plus expenses and loss of interest incurred as a result of the breach.

4-210. SECURITY INTEREST OF COLLECTING BANK IN ITEMS, ACCOMPANYING DOCUMENTS AND PROCEEDS.

(a) A collecting bank has a security interest in an item and any accompanying documents or the proceeds of either:

(1) in case of an item deposited in an account, to the extent to which credit given for the item has been withdrawn or applied;

(2) in case of an item for which it has given credit available for withdrawal as of right, to the extent of the credit given, whether or not the credit is drawn upon or there is a right of charge-back; or

(3) if it makes an advance on or against the item.

(b) If credit given for several items received at one time or pursuant to a single agreement is withdrawn or applied in part, the security interest remains upon all the items, any accompanying documents or the proceeds of either. For the purpose of this section, credits first given are first withdrawn.

(c) Receipt by a collecting bank of a final settlement for an item is a realization on its security interest in the item, accompanying documents, and proceeds. So long as the bank does not receive final settlement for the item or give up possession of the item or possession or control of the accompanying documents for purposes other than collection, the security interest continues to that extent and is subject to Article 9, but:

(1) no security agreement is necessary to make the security interest enforceable (Section 9-203(b)(3)(A));

(2) no filing is required to perfect the security interest; and

(3) the security interest has priority over conflicting perfected security interests in the item, accompanying documents, or proceeds.

4-211. WHEN BANK GIVES VALUE FOR PURPOSES OF HOLDER IN DUE COURSE.

For purposes of determining its status as a holder in due course, a bank has given value to the extent it has a security interest in an item, if the bank otherwise complies with the requirements of Section 3-302 on what constitutes a holder in due course.

4-212. PRESENTMENT BY NOTICE OF ITEM NOT PAYABLE BY, THROUGH, OR AT BANK; LIABILITY OF DRAWER OR INDORSER.

(a) Unless otherwise instructed, a collecting bank may present an item not payable by, through, or at a bank by sending to the party to accept or pay a record providing notice that the bank holds the item for acceptance or payment. The notice must be sent in time to be received on or before the day when presentment is due and the bank must meet any requirement of the party to accept or pay under Section 3-501 by the close of the bank's next banking day after it knows of the requirement.

(b) If presentment is made by notice and payment, acceptance, or request for compliance with a requirement under Section 3-501 is not received by the close of business on the day after maturity or, in the case of demand items, by the close of business on the third banking day after notice was sent, the presenting bank may treat the item as dishonored and charge any drawer or indorser by sending it notice of the facts.

4-213. MEDIUM AND TIME OF SETTLEMENT BY BANK.

(a) With respect to settlement by a bank, the medium and time of settlement may be prescribed by Federal Reserve regulations or circulars, clearing-house rules, and the like, or agreement. In the absence of such prescription:

(1) the medium of settlement is cash or credit to an account in a Federal Reserve bank of or specified by the person to receive settlement; and

(2) the time of settlement, is:

(i) with respect to tender of settlement by cash, a cashier's check, or teller's check, when the cash or check is sent or delivered;

(ii) with respect to tender of settlement by credit in an account in a Federal Reserve Bank, when the credit is made;

(iii) with respect to tender of settlement by a credit or debit to an account in a bank, when the credit or debit is made or, in the case of tender of settlement by authority to charge an account, when the authority is sent or delivered; or

(iv) with respect to tender of settlement by a funds transfer, when payment is made pursuant to Section 4A-406(a) to the person receiving settlement.

(b) If the tender of settlement is not by a medium authorized by subsection (a) or the time of settlement is not fixed by subsection (a), no settlement occurs until the tender of settlement is accepted by the person receiving settlement.

(c) If settlement for an item is made by cashier's check or teller's check and the person receiving settlement, before its midnight deadline:

(1) presents or forwards the check for collection, settlement is final when the check is finally paid; or

(2) fails to present or forward the check for collection, settlement is final at the midnight deadline of the person receiving settlement.

(d) If settlement for an item is made by giving authority to charge the account of the bank giving settlement in the bank receiving settlement, settlement is final when the charge is made by the bank receiving settlement if there are funds available in the account for the amount of the item.

4-214. RIGHT OF CHARGE-BACK OR REFUND; LIABILITY OF COLLECTING BANK; RETURN OF ITEM.

(a) If a collecting bank has made provisional settlement with its customer for an item and fails by reason of dishonor, suspension of payments by a bank, or otherwise to receive settlement for the item which is or becomes final, the bank may revoke the settlement given by it, charge back the amount of any credit given for the item to its customer's account, or obtain refund from its customer, whether or not it is able to return the item, if by its midnight deadline or within a longer reasonable time after it learns the facts it returns the item or sends notification of the facts.

If the return or notice is delayed beyond the bank's midnight deadline or a longer reasonable time after it learns the facts, the bank may revoke the settlement, charge back the credit, or obtain refund from its customer, but it is liable for any loss resulting from the delay. These rights to revoke, charge back, and obtain refund terminate if and when a settlement for the item received by the bank is or becomes final .

(b) A collecting bank returns an item when it is sent or delivered to the bank's customer or transferor or pursuant to its instructions.

(c) A depositary bank that is also the payor may charge back the amount of an item to its customer's account or obtain refund in accordance with the section governing return of an item received by a payor bank for credit on its books (Section 4-301).

(d) The right to charge back is not affected by:

(1) previous use of a credit given for the item; or

(2) failure by any bank to exercise ordinary care with respect to the item, but a bank so failing remains liable.

(e) A failure to charge back or claim refund does not affect other rights of the bank against the customer or any other party.

(f) If credit is given in dollars as the equivalent of the value of an item payable in foreign money, the dollar amount of any charge-back or refund must be calculated on the basis of the bank-offered spot rate for the foreign money prevailing on the day when the person entitled to the charge-back or refund learns that it will not receive payment in ordinary course.

4-215. FINAL PAYMENT OF ITEM BY PAYOR BANK; WHEN PROVISIONAL DEBITS AND CREDITS BECOME FINAL; WHEN CERTAIN CREDITS BECOME AVAILABLE FOR WITHDRAWAL.

(a) An item is finally paid by a payor bank when the bank has first done any of the following:

(1) paid the item in cash;

(2) settled for the item without having a right to revoke the settlement under statute, clearing-house rule, or agreement; or

(3) made a provisional settlement for the item and failed to revoke the settlement in the time and manner permitted by statute, clearing-house rule, or agreement.

(b) If provisional settlement for an item does not become final, the item is not finally paid.

(c) If provisional settlement for an item between the presenting and payor banks is made through a clearing house or by debits or credits in an account between them, then to the extent that provisional debits or credits for the item are entered in accounts between the presenting and payor banks or between the presenting and successive prior collecting banks seriatim, they become final upon final payment of the items by the payor bank.

(d) If a collecting bank receives a settlement for an item which is or becomes final, the bank is accountable to its customer for the amount of the item and any provisional credit given for the item in an account with its customer becomes final.

(e) Subject to (i) applicable law stating a time for availability of funds and (ii) any right of the bank to apply the credit to an obligation of the customer, credit given by a bank for an item in a customer's account becomes available for withdrawal as of right:

(1) if the bank has received a provisional settlement for the item, when the settlement becomes final and the bank has had a reasonable time to receive return of the item and the item has not been received within that time;

(2) if the bank is both the depositary bank and the payor bank, and the item is finally paid, at the opening of the bank's second banking day following receipt of the item.

(f) Subject to applicable law stating a time for availability of funds and any right of a bank to apply a deposit to an obligation of the depositor, a deposit of money becomes available for withdrawal as of right at the opening of the bank's next banking day after receipt of the deposit.

4-216. INSOLVENCY AND PREFERENCE.

(a) If an item is in or comes into the possession of a payor or collecting bank that suspends payment and the item has not been finally paid, the item must be returned by the receiver, trustee, or agent in charge of the closed bank to the presenting bank or the closed bank's customer.

(b) If a payor bank finally pays an item and suspends payments without making a settlement for the item with its customer or the presenting bank which settlement is or becomes final, the owner of the item has a preferred claim against the payor bank.

(c) If a payor bank gives or a collecting bank gives or receives a provisional settlement for an item and thereafter suspends payments, the suspension does not prevent or interfere with the settlement's becoming final if the finality occurs automatically upon the lapse of certain time or the happening of certain events .

(d) If a collecting bank receives from subsequent parties settlement for an item, which settlement is or becomes final and the bank suspends payments without making a settlement for the item with its customer which settlement is or becomes final, the owner of the item has a preferred claim against the collecting bank.

PART 3. COLLECTION OF ITEMS: PAYOR BANKS. [Table of Contents]

4-301. DEFERRED POSTING; RECOVERY OF PAYMENT BY RETURN OF ITEMS; TIME OF DISHONOR; RETURN OF ITEMS BY PAYOR BANK.

(a) If a payor bank settles for a demand item other than a documentary draft presented otherwise than for immediate payment over the counter before midnight of the banking day of receipt, the payor bank may revoke the settlement and recover the settlement if, before it has made final payment and before its midnight deadline, it

(1) returns the item;

(2) returns an image of the item, if the party to which the return is made has entered into an agreement to accept an image as a return of the item; and the image is returned in accordance with that agreement;

(3) sends a record providing notice of dishonor or nonpayment if the item is unavailable for return.

(b) If a demand item is received by a payor bank for credit on its books, it may return the item or send notice of dishonor and may revoke any credit given or recover the amount thereof withdrawn by its customer, if it acts within the time limit and in the manner specified in subsection (a).

(c) Unless previous notice of dishonor has been sent, an item is dishonored at the time when for purposes of dishonor it is returned or notice sent in accordance with this section.

(d) An item is returned:

(1) as to an item presented through a clearing house, when it is delivered to the presenting or last collecting bank or to the clearing house or is sent or delivered in accordance with clearing-house rules; or

(2) in all other cases, when it is sent or delivered to the bank's customer or transferor or pursuant to instructions.

4-302. PAYOR BANK'S RESPONSIBILITY FOR LATE RETURN OF ITEM.

(a) If an item is presented to and received by a payor bank, the bank is accountable for the amount of:

(1) a demand item, other than a documentary draft, whether properly payable or not, if the bank, in any case in which it is not also the depositary bank, retains the item beyond midnight of the banking day of receipt without settling for it or, whether or not it is also the depositary bank, does not pay or return the item or send notice of dishonor until after its midnight deadline; or

(2) any other properly payable item unless, within the time allowed for acceptance or payment of that item, the bank either accepts or pays the item or returns it and accompanying documents.

(b) The liability of a payor bank to pay an item pursuant to subsection (a) is subject to defenses based on breach of a presentment warranty (Section 4-208) or proof that the person seeking enforcement of the liability presented or transferred the item for the purpose of defrauding the payor bank.

4-303. WHEN ITEMS SUBJECT TO NOTICE, STOP-PAYMENT ORDER, LEGAL PROCESS, OR SETOFF; ORDER IN WHICH ITEMS MAY BE CHARGED OR CERTIFIED.

(a) Any knowledge, notice, or stop-payment order received by, legal process served upon, or setoff exercised by a payor bank comes too late to terminate, suspend, or modify the bank's right or duty to pay an item or to charge its customer's account for the item if the knowledge, notice, stop-payment order, or legal process is received or served and a reasonable time for the bank to act thereon expires or the setoff is exercised after the earliest of the following:

(1) the bank accepts or certifies the item;

(2) the bank pays the item in cash;

(3) the bank settles for the item without having a right to revoke the settlement under statute, clearing-house rule, or agreement;

(4) the bank becomes accountable for the amount of the item under Section 4-302 dealing with the payor bank's responsibility for late return of items; or

(5) with respect to checks, a cutoff hour no earlier than one hour after the opening of the next banking day after the banking day on which the bank received the check and no later than the close of that next banking day or, if no cutoff hour is fixed, the close of the next banking day after the banking day on which the bank received the check.

(b) Subject to subsection (a), items may be accepted, paid, certified, or charged to the indicated account of its customer in any order.

PART 4. RELATIONSHIP BETWEEN PAYOR BANK AND ITS CUSTOMER [Table of Contents]

4-401. WHEN BANK MAY CHARGE CUSTOMER'S ACCOUNT.

(a) A bank may charge against the account of a customer an item that is properly payable from that account even though the charge creates an overdraft. An item is properly payable if it is authorized by the customer and is in accordance with any agreement between the customer and bank.

(b) A customer is not liable for the amount of an overdraft if the customer neither signed the item nor benefited from the proceeds of the item.

(c) A bank may charge against the account of a customer a check that is otherwise properly payable from the account, even though payment was made before the date of the check, unless the customer has given notice to the bank of the postdating describing the check with reasonable certainty. The notice is effective for the period stated in Section 4-403(b) for stop-payment orders, and must be received at such time and in such manner as to afford the bank a reasonable opportunity to act on it before the bank takes any action with respect to the check described in Section 4-303. If a bank charges against the account of a customer a check before the date stated in the notice of postdating, the bank is liable for damages for the loss resulting from its act. The loss may include damages for dishonor of subsequent items under Section 4-402.

(d) A bank that in good faith makes payment to a holder may charge the indicated account of its customer according to:

(1) the original terms of the altered item; or

(2) the terms of the completed item, even though the bank knows the item has been completed unless the bank has notice that the completion was improper.

4-402. BANK'S LIABILITY TO CUSTOMER FOR WRONGFUL DISHONOR; TIME OF DETERMINING INSUFFICIENCY OF ACCOUNT.

(a) Except as otherwise provided in this Article, a payor bank wrongfully dishonors an item if it dishonors an item that is properly payable, but a bank may dishonor an item that would create an overdraft unless it has agreed to pay the overdraft.

(b) A payor bank is liable to its customer for damages proximately caused by the wrongful dishonor of an item. Liability is limited to actual damages proved and may include damages for an arrest or prosecution of the customer or other consequential damages. Whether any consequential damages are proximately caused by the wrongful dishonor is a question of fact to be determined in each case.

(c) A payor bank's determination of the customer's account balance on which a decision to dishonor for insufficiency of available funds is based may be made at any time between the time the item is received by the payor bank and the time that the payor bank returns the item or gives notice in lieu of return, and no more than one determination need be made. If, at the election of the payor bank, a subsequent balance determination is made for the purpose of reevaluating the bank's decision to dishonor the item, the account balance at that time is determinative of whether a dishonor for insufficiency of available funds is wrongful.

4-403. CUSTOMER'S RIGHT TO STOP PAYMENT; BURDEN OF PROOF OF LOSS.

(a) A customer or any person authorized to draw on the account if there is more than one person may stop payment of any item drawn on the customer's account or close the account by an order to the bank describing the item or account with reasonable certainty received at a time and in a manner that affords the bank a reasonable opportunity to act on it before any action by the bank with respect to the item described in Section 4-303. If the signature of more than one person is required to draw on an account, any of these persons may stop payment or close the account.

(b) A stop-payment order is effective for six months, but it lapses after 14 calendar days if the original order was oral and was not confirmed in a record within that period. A stop-payment order may be renewed for additional six-month periods by a record given to the bank within a period during which the stop-payment order is effective.

(c) The burden of establishing the fact and amount of loss resulting from the payment of an item contrary to a stop-payment order or order to close an account is on the customer. The loss from payment of an item contrary to a stop-payment order may include damages for dishonor of subsequent items under Section 4-402.

4-404. BANK NOT OBLIGED TO PAY CHECK MORE THAN SIX MONTHS OLD.

A bank is under no obligation to a customer having a checking account to pay a check, other than a certified check, which is presented more than six months after its date, but it may charge its customer's account for a payment made thereafter in good faith.

4-405. DEATH OR INCOMPETENCE OF CUSTOMER.

(a) A payor or collecting bank's authority to accept, pay, or collect an item or to account for proceeds of its collection, if otherwise effective, is not rendered ineffective by incompetence of a customer of either bank existing at the time the item is issued or its collection is undertaken if the bank does not know of an adjudication of incompetence. Neither death nor incompetence of a customer revokes the authority to accept, pay, collect, or account until the bank knows of the fact of death or of an adjudication of incompetence and has reasonable opportunity to act on it.

(b) Even with knowledge, a bank may for 10 days after the date of death pay or certify checks drawn on or before that date unless ordered to stop payment by a person claiming an interest in the account.

4-406. CUSTOMER'S DUTY TO DISCOVER AND REPORT UNAUTHORIZED SIGNATURE OR ALTERATION.

(a) A bank that sends or makes available to a customer a statement of account showing payment of items for the account shall either return or make available to the customer the items paid or provide information in the statement of account sufficient to allow the customer reasonably to identify the

items paid. The statement of account provides sufficient information if the item is described by item number, amount, and date of payment.

(b) If the items are not returned to the customer, the person retaining the items shall either retain the items or, if the items are destroyed, maintain the capacity to furnish legible copies of the items until the expiration of seven years after receipt of the items. A customer may request an item from the bank that paid the item, and that bank must provide in a reasonable time either the item or, if the item has been destroyed or is not otherwise obtainable, a legible copy of the item.

(c) If a bank sends or makes available a statement of account or items pursuant to subsection (a), the customer must exercise reasonable promptness in examining the statement or the items to determine whether any payment was not authorized because of an alteration of an item or because a purported signature by or on behalf of the customer was not authorized. If, based on the statement or items provided, the customer should reasonably have discovered the unauthorized payment, the customer must promptly notify the bank of the relevant facts.

(d) If the bank proves that the customer failed, with respect to an item, to comply with the duties imposed on the customer by subsection (c), the customer is precluded from asserting against the bank:

(1) the customer's unauthorized signature or any alteration on the item, if the bank also proves that it suffered a loss by reason of the failure; and

(2) the customer's unauthorized signature or alteration by the same wrongdoer on any other item paid in good faith by the bank if the payment was made before the bank received notice from the customer of the unauthorized signature or alteration and after the customer had been afforded a reasonable period of time, not exceeding 30 days, in which to examine the item or statement of account and notify the bank.

(e) If subsection (d) applies and the customer proves that the bank failed to exercise ordinary care in paying the item and that the failure substantially contributed to loss, the loss is allocated between the customer precluded and the bank asserting the preclusion according to the extent to which the failure of the customer to comply with subsection (c) and the failure of the bank to exercise ordinary care contributed to the loss. If the customer proves that the bank did not pay the item in good faith, the preclusion under subsection (d) does not apply.

(f) Without regard to care or lack of care of either the customer or the bank, a customer who does not within one year after the statement or items are made available to the customer (subsection (a)) discover and report the customer's unauthorized signature on or any alteration on the item is precluded from asserting against the bank the unauthorized signature or alteration. If there is a preclusion under this subsection, the payor bank may not recover for breach of warranty under Section 4-208 with respect to the unauthorized signature or alteration to which the preclusion applies.

4-407. PAYOR BANK'S RIGHT TO SUBROGATION ON IMPROPER PAYMENT.

If a payor bank has paid an item over the order of the drawer or maker to stop payment, or after an account has been closed, or otherwise under circumstances giving a basis for objection by the drawer or maker, to prevent unjust enrichment and only to the extent necessary to prevent loss to the bank by reason of its payment of the item, the payor bank is subrogated to the rights

(1) of any holder in due course on the item against the drawer or maker;

(2) of the payee or any other holder of the item against the drawer or maker either on the item or under the transaction out of which the item arose; and

(3) of the drawer or maker against the payee or any other holder of the item with respect to the transaction out of which the item arose.

PART 5. COLLECTION OF DOCUMENTATARY DRAFTS [Table of Contents]

4-501. HANDLING OF DOCUMENTARY DRAFTS; DUTY TO SEND FOR PRESENTMENT AND TO NOTIFY CUSTOMER OF DISHONOR.

A bank that takes a documentary draft for collection shall present or send the draft and accompanying documents for presentment and, upon learning that the draft has not been paid or accepted in due course, shall seasonably notify its customer of the fact even though it may have discounted or bought the draft or extended credit available for withdrawal as of right.

4-502. PRESENTMENT OF "ON ARRIVAL" DRAFTS.

If a draft or the relevant instructions require presentment "on arrival", "when goods arrive" or the like, the collecting bank need not present until in its judgment a reasonable time for arrival of the goods has expired. Refusal to pay or accept because the goods have not arrived is not dishonor; the bank must

notify its transferor of the refusal but need not present the draft again until it is instructed to do so or learns of the arrival of the goods.

4-503. RESPONSIBILITY OF PRESENTING BANK FOR DOCUMENTS AND GOODS; REPORT OF REASONS FOR DISHONOR; REFEREE IN CASE OF NEED.

Unless otherwise instructed and except as provided in Article 5, a bank presenting a documentary draft:

(1) must deliver the documents to the drawee on acceptance of the draft if it is payable more than three days after presentment; otherwise, only on payment; and

(2) upon dishonor, either in the case of presentment for acceptance or presentment for payment, may seek and follow instructions from any referee in case of need designated in the draft or, if the presenting bank does not choose to utilize the referee's services, it must use diligence and good faith to ascertain the reason for dishonor, must notify its transferor of the dishonor and of the results of its effort to ascertain the reasons therefor, and must request instructions.

However the presenting bank is under no obligation with respect to goods represented by the documents except to follow any reasonable instructions seasonably received; it has a right to reimbursement for any expense incurred in following instructions and to prepayment of or indemnity for those expenses.

4-504. PRIVILEGE OF PRESENTING BANK TO DEAL WITH GOODS; SECURITY INTEREST FOR EXPENSES.

(a) A presenting bank that, following the dishonor of a documentary draft, has seasonably requested instructions but does not receive them within a reasonable time may store, sell, or otherwise deal with the goods in any reasonable manner.

(b) For its reasonable expenses incurred by action under subsection (a), the presenting bank has a lien upon the goods or their proceeds, which may be foreclosed in the same manner as an unpaid seller's lien.

ARTICLE 4A - FUNDS TRANSFER

PART 1. SUBJECT MATTER AND DEFINITIONS [Table of Contents]

4A-101. SHORT TITLE.

This Article may be cited as Uniform Commercial Code--Funds Transfers.

4A-102. SUBJECT MATTER.

Except as otherwise provided in Section 4A-108, this Article applies to funds transfers defined in Section 4A-104.

4A-103. PAYMENT ORDER - DEFINITIONS.

(a) In this Article:

(1) "**Payment order**" means an instruction of a sender to a receiving bank, transmitted orally, electronically, or in writing, to pay, or to cause another bank to pay, a fixed or determinable amount of money to a beneficiary if:

(i) the instruction does not state a condition to payment to the beneficiary other than time of payment,

(ii) the receiving bank is to be reimbursed by debiting an account of, or otherwise receiving payment from, the sender, and

(iii) the instruction is transmitted by the sender directly to the receiving bank or to an agent, funds-transfer system, or communication system for transmittal to the receiving bank.

(2) "**Beneficiary**" means the person to be paid by the beneficiary's bank.

(3) "**Beneficiary's bank**" means the bank identified in a payment order in which an account of the beneficiary is to be credited pursuant to the order or which otherwise is to make payment to the beneficiary if the order does not provide for payment to an account.

(4) "**Receiving bank**" means the bank to which the sender's instruction is addressed.

(5) "**Sender**" means the person giving the instruction to the receiving bank.

(b) If an instruction complying with subsection (a)(1) is to make more than one payment to a beneficiary, the instruction is a separate payment order with respect to each payment.

(c) A payment order is issued when it is sent to the receiving bank.

4A-104. FUNDS TRANSFER - DEFINITIONS.

In this Article:

(a) "**Funds transfer**" means the series of transactions, beginning with the originator's payment order, made for the purpose of making payment to the beneficiary of the order. The term includes any payment order issued by the originator's bank or an intermediary bank intended to carry out the originator's payment order. A funds transfer is completed by acceptance by the beneficiary's bank of a payment order for the benefit of the beneficiary of the originator's payment order.

(b) "**Intermediary bank**" means a receiving bank other than the originator's bank or the beneficiary's bank.

(c) "**Originator**" means the sender of the first payment order in a funds transfer.

(d) "**Originator's bank**" means (i) the receiving bank to which the payment order of the originator is issued if the originator is not a bank, or (ii) the originator if the originator is a bank.

4A-105. OTHER DEFINITIONS.

(a) In this Article:

(1) "**Authorized account**" means a deposit account of a customer in a bank designated by the customer as a source of payment of payment orders issued by the customer to the bank. If a customer does not so designate an account, any account of the customer is an authorized account if payment of a payment order from that account is not inconsistent with a restriction on the use of that account.

(2) "**Bank**" means a person engaged in the business of banking and includes a savings bank, savings and loan association, credit union, and trust company. A branch or separate office of a bank is a separate bank for purposes of this Article.

(3) "**Customer**" means a person, including a bank, having an account with a bank or from whom a bank has agreed to receive payment orders.

(4) "**Funds-transfer business day**" of a receiving bank means the part of a day during which the receiving bank is open for the receipt, processing, and transmittal of payment orders and cancellations and amendments of payment orders.

(5) "**Funds-transfer system**" means a wire transfer network, automated clearing house, or other communication system of a clearing house or other association of banks through which a payment order by a bank may be transmitted to the bank to which the order is addressed.

(6) [reserved]

(7) "**Prove**" with respect to a fact means to meet the burden of establishing the fact (Section 1-201(b)(8)).

(b) Other definitions applying to this Article and the sections in which they appear are:

"**Acceptance**"	Section 4A-209
"**Beneficiary**"	Section 4A-103
"**Beneficiary's bank**"	Section 4A-103
"**Executed**"	Section 4A-301
"**Execution date**"	Section 4A-301
"**Funds transfer**"	Section 4A-104
"**Funds-transfer system rule**"	Section 4A-501
"**Intermediary bank**"	Section 4A-104
"**Originator**"	Section 4A-104
"**Originator's bank**"	Section 4A-104
"**Payment by beneficiary's bank to beneficiary**"	Section 4A-405
"**Payment by originator tobeneficiary**"	Section 4A-406
"**Payment by sender to receiving bank**"	Section 4A-403
"**Payment date**"	Section 4A-401

"**Payment order**"	Section 4A-103
"**Receiving bank**"	Section 4A-103
"**Security procedure**"	Section 4A-201
"**Sender**"	Section 4A-103

(c) The following definitions in Article 4 apply to this Article:

"**Clearing house**"	Section 4-104
"**Item**"	Section 4-104
"**Suspends payments**"	Section 4-104

(d) In addition Article 1 contains general definitions and principles of construction and interpretation applicable throughout this Article.

4A-106. TIME PAYMENT ORDER IS RECEIVED.

(a) The time of receipt of a payment order or communication cancelling or amending a payment order is determined by the rules applicable to receipt of a notice stated in Section 1-202. A receiving bank may fix a cut-off time or times on a funds-transfer business day for the receipt and processing of payment orders and communications cancelling or amending payment orders. Different cut-off times may apply to payment orders, cancellations, or amendments, or to different categories of payment orders, cancellations, or amendments.

A cut-off time may apply to senders generally or different cut-off times may apply to different senders or categories of payment orders. If a payment order or communication cancelling or amending a payment order is received after the close of a funds-transfer business day or after the appropriate cut-off time on a funds-transfer business day, the receiving bank may treat the payment order or communication as received at the opening of the next funds-transfer business day.

(b) If this Article refers to an execution date or payment date or states a day on which a receiving bank is required to take action, and the date or day does not fall on a funds-transfer business day, the next day that is a funds-transfer business day is treated as the date or day stated, unless the contrary is stated in this Article.

4A-107. FEDERAL RESERVE REGULATIONS AND OPERATING CIRCULARS.

Regulations of the Board of Governors of the Federal Reserve System and operating circulars of the Federal Reserve Banks supersede any inconsistent provision of this Article to the extent of the inconsistency.

4A-108. EXCLUSION OF CONSUMER TRANSACTIONS GOVERNED BY FEDERAL LAW.

This Article does not apply to a funds transfer any part of which is governed by the Electronic Fund Transfer Act of 1978 (Title XX, Public Law 95-630, 92 Stat. 3728, 15 U.S.C. 1693 et seq.) as amended from time to time.

PART 2. ISSUE AND ACCEPTANCE OF PAYMENT ORDER [Table of Contents]

4A-201. SECURITY PROCEDURE.

"**Security procedure**" means a procedure established by agreement of a customer and a receiving bank for the purpose of (i) verifying that a payment order or communication amending or cancelling a payment order is that of the customer, or (ii) detecting error in the transmission or the content of the payment order or communication. A security procedure may require the use of algorithms or other codes, identifying words or numbers, encryption, callback procedures, or similar security devices. Comparison of a signature on a payment order or communication with an authorized specimen signature of the customer is not by itself a security procedure.

4A-202. AUTHORIZED AND VERIFIED PAYMENT ORDERS.

(a) A payment order received by the receiving bank is the authorized order of the person identified as sender if that person authorized the order or is otherwise bound by it under the law of agency.

(b) If a bank and its customer have agreed that the authenticity of payment orders issued to the bank in the name of the customer as sender will be verified pursuant to a security procedure, a payment order received by the receiving bank is effective as the order of the customer, whether or not authorized, if (i) the security procedure is a commercially reasonable method of providing security against unauthorized payment orders, and (ii) the bank proves that it accepted the payment order in good faith and in compliance with the security procedure and any written agreement or instruction of the customer restricting acceptance of payment orders issued in the name of the customer. The bank

is not required to follow an instruction that violates a written agreement with the customer or notice of which is not received at a time and in a manner affording the bank a reasonable opportunity to act on it before the payment order is accepted.

(c) Commercial reasonableness of a security procedure is a question of law to be determined by considering the wishes of the customer expressed to the bank, the circumstances of the customer known to the bank, including the size, type, and frequency of payment orders normally issued by the customer to the bank, alternative security procedures offered to the customer, and security procedures in general use by customers and receiving banks similarly situated. A security procedure is deemed to be commercially reasonable if (i) the security procedure was chosen by the customer after the bank offered, and the customer refused, a security procedure that was commercially reasonable for that customer, and (ii) the customer expressly agreed in writing to be bound by any payment order, whether or not authorized, issued in its name and accepted by the bank in compliance with the security procedure chosen by the customer.

(d) The term "**sender**" in this Article includes the customer in whose name a payment order is issued if the order is the authorized order of the customer under subsection (a), or it is effective as the order of the customer under subsection (b).

(e) This section applies to amendments and cancellations of payment orders to the same extent it applies to payment orders.

(f) Except as provided in this section and in Section 4A-203(a)(1), rights and obligations arising under this section or Section 4A-203 may not be varied by agreement.

4A-203. UNENFORCEABILITY OF CERTAIN VERIFIED PAYMENT ORDERS.

(a) If an accepted payment order is not, under Section 4A-202(a), an authorized order of a customer identified as sender, but is effective as an order of the customer pursuant to Section 4A-202(b), the following rules apply:

(1) By express written agreement, the receiving bank may limit the extent to which it is entitled to enforce or retain payment of the payment order.

(2) The receiving bank is not entitled to enforce or retain payment of the payment order if the customer proves that the order was not caused, directly or indirectly, by a person (i) entrusted at any time with duties to act for the customer with respect to payment orders or the security procedure, or (ii) who obtained access to transmitting facilities of the customer or who obtained, from a source controlled by the customer and without authority of the receiving bank, information facilitating breach of the security procedure, regardless of how the information was obtained or whether the customer was at fault. Information includes any access device, computer software, or the like.

(b) This section applies to amendments of payment orders to the same extent it applies to payment orders.

4A-204. REFUND OF PAYMENT AND DUTY OF CUSTOMER TO REPORT WITH RESPECT TO UNAUTHORIZED PAYMENT ORDER.

(a) If a receiving bank accepts a payment order issued in the name of its customer as sender which is (i) not authorized and not effective as the order of the customer under Section 4A-202, or (ii) not enforceable, in whole or in part, against the customer under Section 4A-203, the bank shall refund any payment of the payment order received from the customer to the extent the bank is not entitled to enforce payment and shall pay interest on the refundable amount calculated from the date the bank received payment to the date of the refund.

However, the customer is not entitled to interest from the bank on the amount to be refunded if the customer fails to exercise ordinary care to determine that the order was not authorized by the customer and to notify the bank of the relevant facts within a reasonable time not exceeding 90 days after the date the customer received notification from the bank that the order was accepted or that the customer's account was debited with respect to the order. The bank is not entitled to any recovery from the customer on account of a failure by the customer to give notification as stated in this section.

(b) Reasonable time under subsection (a) may be fixed by agreement as stated in Section 1-204(1), but the obligation of a receiving bank to refund payment as stated in subsection (a) may not otherwise be varied by agreement.

4A-205. ERRONEOUS PAYMENT ORDERS.

(a) If an accepted payment order was transmitted pursuant to a security procedure for the detection of error and the payment order (i) erroneously instructed payment to a beneficiary not intended by the sender, (ii) erroneously instructed payment in an amount greater than the amount intended by the

sender, or (iii) was an erroneously transmitted duplicate of a payment order previously sent by the sender, the following rules apply:

(1) If the sender proves that the sender or a person acting on behalf of the sender pursuant to Section 4A-206 complied with the security procedure and that the error would have been detected if the receiving bank had also complied, the sender is not obliged to pay the order to the extent stated in paragraphs (2) and (3).

(2) If the funds transfer is completed on the basis of an erroneous payment order described in clause (i) or (iii) of subsection (a), the sender is not obliged to pay the order and the receiving bank is entitled to recover from the beneficiary any amount paid to the beneficiary to the extent allowed by the law governing mistake and restitution.

(3) If the funds transfer is completed on the basis of a payment order described in clause (ii) of subsection (a), the sender is not obliged to pay the order to the extent the amount received by the beneficiary is greater than the amount intended by the sender. In that case, the receiving bank is entitled to recover from the beneficiary the excess amount received to the extent allowed by the law governing mistake and restitution.

(b) If (i) the sender of an erroneous payment order described in subsection (a) is not obliged to pay all or part of the order, and (ii) the sender receives notification from the receiving bank that the order was accepted by the bank or that the sender's account was debited with respect to the order, the sender has a duty to exercise ordinary care, on the basis of information available to the sender, to discover the error with respect to the order and to advise the bank of the relevant facts within a reasonable time, not exceeding 90 days, after the bank's notification was received by the sender. If the bank proves that the sender failed to perform that duty, the sender is liable to the bank for the loss the bank proves it incurred as a result of the failure, but the liability of the sender may not exceed the amount of the sender's order.

(c) This section applies to amendments to payment orders to the same extent it applies to payment orders.

4A-206. TRANSMISSION OF PAYMENT ORDER THROUGH FUNDS-TRANSFER OR OTHER COMMUNICATION SYSTEM.

(a) If a payment order addressed to a receiving bank is transmitted to a funds-transfer system or other third-party communication system for transmittal to the bank, the system is deemed to be an agent of the sender for the purpose of transmitting the payment order to the bank. If there is a discrepancy between the terms of the payment order transmitted to the system and the terms of the payment order transmitted by the system to the bank, the terms of the payment order of the sender are those transmitted by the system. This section does not apply to a funds-transfer system of the Federal Reserve Banks.

(b) This section applies to cancellations and amendments of payment orders to the same extent it applies to payment orders.

4A-207. MISDESCRIPTION OF BENEFICIARY.

(a) Subject to subsection (b), if, in a payment order received by the beneficiary's bank, the name, bank account number, or other identification of the beneficiary refers to a nonexistent or unidentifiable person or account, no person has rights as a beneficiary of the order and acceptance of the order cannot occur.

(b) If a payment order received by the beneficiary's bank identifies the beneficiary both by name and by an identifying or bank account number and the name and number identify different persons, the following rules apply:

(1) Except as otherwise provided in subsection (c), if the beneficiary's bank does not know that the name and number refer to different persons, it may rely on the number as the proper identification of the beneficiary of the order. The beneficiary's bank need not determine whether the name and number refer to the same person.

(2) If the beneficiary's bank pays the person identified by name or knows that the name and number identify different persons, no person has rights as beneficiary except the person paid by the beneficiary's bank if that person was entitled to receive payment from the originator of the funds transfer. If no person has rights as beneficiary, acceptance of the order cannot occur.

(c) If (i) a payment order described in subsection (b) is accepted, (ii) the originator's payment order described the beneficiary inconsistently by name and number, and (iii) the beneficiary's bank pays the person identified by number as permitted by subsection (b)(1), the following rules apply:

(1) If the originator is a bank, the originator is obliged to pay its order.

(2) If the originator is not a bank and proves that the person identified by number was not entitled to receive payment from the originator, the originator is not obliged to pay its order unless the originator's bank proves that the originator, before acceptance of the originator's order, had notice that payment of a payment order issued by the originator might be made by the beneficiary's bank on the basis of an identifying or bank account number even if it identifies a person different from the named beneficiary. Proof of notice may be made by any admissible evidence. The originator's bank satisfies the burden of proof if it proves that the originator, before the payment order was accepted, signed a writing stating the information to which the notice relates.

(d) In a case governed by subsection (b)(1), if the beneficiary's bank rightfully pays the person identified by number and that person was not entitled to receive payment from the originator, the amount paid may be recovered from that person to the extent allowed by the law governing mistake and restitution as follows:

(1) If the originator is obliged to pay its payment order as stated in subsection (c), the originator has the right to recover.

(2) If the originator is not a bank and is not obliged to pay its payment order, the originator's bank has the right to recover.

4A-208. MISDESCRIPTION OF INTERMEDIARY BANK OR BENEFICIARY'S BANK.

(a) This subsection applies to a payment order identifying an intermediary bank or the beneficiary's bank only by an identifying number.

(1) The receiving bank may rely on the number as the proper identification of the intermediary or beneficiary's bank and need not determine whether the number identifies a bank.

(2) The sender is obliged to compensate the receiving bank for any loss and expenses incurred by the receiving bank as a result of its reliance on the number in executing or attempting to execute the order.

(b) This subsection applies to a payment order identifying an intermediary bank or the beneficiary's bank both by name and an identifying number if the name and number identify different persons.

(1) If the sender is a bank, the receiving bank may rely on the number as the proper identification of the intermediary or beneficiary's bank if the receiving bank, when it executes the sender's order, does not know that the name and number identify different persons. The receiving bank need not determine whether the name and number refer to the same person or whether the number refers to a bank. The sender is obliged to compensate the receiving bank for any loss and expenses incurred by the receiving bank as a result of its reliance on the number in executing or attempting to execute the order.

(2) If the sender is not a bank and the receiving bank proves that the sender, before the payment order was accepted, had notice that the receiving bank might rely on the number as the proper identification of the intermediary or beneficiary's bank even if it identifies a person different from the bank identified by name, the rights and obligations of the sender and the receiving bank are governed by subsection (b)(1), as though the sender were a bank. Proof of notice may be made by any admissible evidence. The receiving bank satisfies the burden of proof if it proves that the sender, before the payment order was accepted, signed a writing stating the information to which the notice relates.

(3) Regardless of whether the sender is a bank, the receiving bank may rely on the name as the proper identification of the intermediary or beneficiary's bank if the receiving bank, at the time it executes the sender's order, does not know that the name and number identify different persons. The receiving bank need not determine whether the name and number refer to the same person.

(4) If the receiving bank knows that the name and number identify different persons, reliance on either the name or the number in executing the sender's payment order is a breach of the obligation stated in Section 4A-302(a)(1).

4A-209. ACCEPTANCE OF PAYMENT ORDER.

(a) Subject to subsection (d), a receiving bank other than the beneficiary's bank accepts a payment order when it executes the order.

(b) Subject to subsections (c) and (d), a beneficiary's bank accepts a payment order at the earliest of the following times:

(1) when the bank (i) pays the beneficiary as stated in Section 4A-405(a) or 4A-405(b), or (ii) notifies the beneficiary of receipt of the order or that the account of the beneficiary has been credited with respect to the order unless the notice indicates that the bank is rejecting the order or

that funds with respect to the order may not be withdrawn or used until receipt of payment from the sender of the order;

(2) when the bank receives payment of the entire amount of the sender's order pursuant to Section 4A-403(a)(1) or 4A-403(a)(2); or

(3) the opening of the next funds-transfer business day of the bank following the payment date of the order if, at that time, the amount of the sender's order is fully covered by a withdrawable credit balance in an authorized account of the sender or the bank has otherwise received full payment from the sender, unless the order was rejected before that time or is rejected within (i) one hour after that time, or (ii) one hour after the opening of the next business day of the sender following the payment date if that time is later.

If notice of rejection is received by the sender after the payment date and the authorized account of the sender does not bear interest, the bank is obliged to pay interest to the sender on the amount of the order for the number of days elapsing after the payment date to the day the sender receives notice or learns that the order was not accepted, counting that day as an elapsed day. If the withdrawable credit balance during that period falls below the amount of the order, the amount of interest payable is reduced accordingly.

(c) Acceptance of a payment order cannot occur before the order is received by the receiving bank. Acceptance does not occur under subsection (b)(2) or (b)(3) if the beneficiary of the payment order does not have an account with the receiving bank, the account has been closed, or the receiving bank is not permitted by law to receive credits for the beneficiary's account.

(d) A payment order issued to the originator's bank cannot be accepted until the payment date if the bank is the beneficiary's bank, or the execution date if the bank is not the beneficiary's bank. If the originator's bank executes the originator's payment order before the execution date or pays the beneficiary of the originator's payment order before the payment date and the payment order is subsequently canceled pursuant to Section 4A-211(b), the bank may recover from the beneficiary any payment received to the extent allowed by the law governing mistake and restitution.

4A-210. REJECTION OF PAYMENT ORDER.

(a) A payment order is rejected by the receiving bank by a notice of rejection transmitted to the sender orally, electronically, or in writing. A notice of rejection need not use any particular words and is sufficient if it indicates that the receiving bank is rejecting the order or will not execute or pay the order. Rejection is effective when the notice is given if transmission is by a means that is reasonable in the circumstances. If notice of rejection is given by a means that is not reasonable, rejection is effective when the notice is received. If an agreement of the sender and receiving bank establishes the means to be used to reject a payment order, (i) any means complying with the agreement is reasonable and (ii) any means not complying is not reasonable unless no significant delay in receipt of the notice resulted from the use of the noncomplying means.

(b) This subsection applies if a receiving bank other than the beneficiary's bank fails to execute a payment order despite the existence on the execution date of a withdrawable credit balance in an authorized account of the sender sufficient to cover the order. If the sender does not receive notice of rejection of the order on the execution date and the authorized account of the sender does not bear interest, the bank is obliged to pay interest to the sender on the amount of the order for the number of days elapsing after the execution date to the earlier of the day the order is canceled pursuant to Section 4A-211(d) or the day the sender receives notice or learns that the order was not executed, counting the final day of the period as an elapsed day. If the withdrawable credit balance during that period falls below the amount of the order, the amount of interest is reduced accordingly.

(c) If a receiving bank suspends payments, all unaccepted payment orders issued to it are deemed rejected at the time the bank suspends payments.

(d) Acceptance of a payment order precludes a later rejection of the order. Rejection of a payment order precludes a later acceptance of the order.

4A-211. CANCELLATION AND AMENDMENT OF PAYMENT ORDER.

(a) A communication of the sender of a payment order cancelling or amending the order may be transmitted to the receiving bank orally, electronically, or in writing. If a security procedure is in effect between the sender and the receiving bank, the communication is not effective to cancel or amend the order unless the communication is verified pursuant to the security procedure or the bank agrees to the cancellation or amendment.

(b) Subject to subsection (a), a communication by the sender cancelling or amending a payment order is effective to cancel or amend the order if notice of the communication is received at a time

and in a manner affording the receiving bank a reasonable opportunity to act on the communication before the bank accepts the payment order.

(c) After a payment order has been accepted, cancellation or amendment of the order is not effective unless the receiving bank agrees or a funds-transfer system rule allows cancellation or amendment without agreement of the bank.

(1) With respect to a payment order accepted by a receiving bank other than the beneficiary's bank, cancellation or amendment is not effective unless a conforming cancellation or amendment of the payment order issued by the receiving bank is also made.

(2) With respect to a payment order accepted by the beneficiary's bank, cancellation or amendment is not effective unless the order was issued in execution of an unauthorized payment order, or because of a mistake by a sender in the funds transfer which resulted in the issuance of a payment order (i) that is a duplicate of a payment order previously issued by the sender, (ii) that orders payment to a beneficiary not entitled to receive payment from the originator, or (iii) that orders payment in an amount greater than the amount the beneficiary was entitled to receive from the originator. If the payment order is canceled or amended, the beneficiary's bank is entitled to recover from the beneficiary any amount paid to the beneficiary to the extent allowed by the law governing mistake and restitution.

(d) An unaccepted payment order is canceled by operation of law at the close of the fifth funds-transfer business day of the receiving bank after the execution date or payment date of the order.

(e) A canceled payment order cannot be accepted. If an accepted payment order is canceled, the acceptance is nullified and no person has any right or obligation based on the acceptance. Amendment of a payment order is deemed to be cancellation of the original order at the time of amendment and issue of a new payment order in the amended form at the same time.

(f) Unless otherwise provided in an agreement of the parties or in a funds-transfer system rule, if the receiving bank, after accepting a payment order, agrees to cancellation or amendment of the order by the sender or is bound by a funds-transfer system rule allowing cancellation or amendment without the bank's agreement, the sender, whether or not cancellation or amendment is effective, is liable to the bank for any loss and expenses, including reasonable attorney's fees, incurred by the bank as a result of the cancellation or amendment or attempted cancellation or amendment.

(g) A payment order is not revoked by the death or legal incapacity of the sender unless the receiving bank knows of the death or of an adjudication of incapacity by a court of competent jurisdiction and has reasonable opportunity to act before acceptance of the order.

(h) A funds-transfer system rule is not effective to the extent it conflicts with subsection (c)(2).

4A-212. LIABILITY AND DUTY OF RECEIVING BANK REGARDING UNACCEPTED PAYMENT ORDER.

If a receiving bank fails to accept a payment order that it is obliged by express agreement to accept, the bank is liable for breach of the agreement to the extent provided in the agreement or in this Article, but does not otherwise have any duty to accept a payment order or, before acceptance, to take any action, or refrain from taking action, with respect to the order except as provided in this Article or by express agreement. Liability based on acceptance arises only when acceptance occurs as stated in Section 4A-209, and liability is limited to that provided in this Article. A receiving bank is not the agent of the sender or beneficiary of the payment order it accepts, or of any other party to the funds transfer, and the bank owes no duty to any party to the funds transfer except as provided in this Article or by express agreement.

PART 3. EXECUTION OF SENDER'S PAYMENT ORDER BY RECEIVING BANK [Table of Contents]

4A-301. EXECUTION AND EXECUTION DATE.

(a) A payment order is "**executed**" by the receiving bank when it issues a payment order intended to carry out the payment order received by the bank. A payment order received by the beneficiary's bank can be accepted but cannot be executed.

(b) "**Execution date**" of a payment order means the day on which the receiving bank may properly issue a payment order in execution of the sender's order. The execution date may be determined by instruction of the sender but cannot be earlier than the day the order is received and, unless otherwise determined, is the day the order is received. If the sender's instruction states a payment date, the execution date is the payment date or an earlier date on which execution is reasonably necessary to allow payment to the beneficiary on the payment date.

4A-302. OBLIGATIONS OF RECEIVING BANK IN EXECUTION OF PAYMENT ORDER.

(a) Except as provided in subsections (b) through (d), if the receiving bank accepts a payment order pursuant to Section 4A-209(a), the bank has the following obligations in executing the order:

(1) The receiving bank is obliged to issue, on the execution date, a payment order complying with the sender's order and to follow the sender's instructions concerning (i) any intermediary bank or funds-transfer system to be used in carrying out the funds transfer, or (ii) the means by which payment orders are to be transmitted in the funds transfer. If the originator's bank issues a payment order to an intermediary bank, the originator's bank is obliged to instruct the intermediary bank according to the instruction of the originator. An intermediary bank in the funds transfer is similarly bound by an instruction given to it by the sender of the payment order it accepts.

(2) If the sender's instruction states that the funds transfer is to be carried out telephonically or by wire transfer or otherwise indicates that the funds transfer is to be carried out by the most expeditious means, the receiving bank is obliged to transmit its payment order by the most expeditious available means, and to instruct any intermediary bank accordingly. If a sender's instruction states a payment date, the receiving bank is obliged to transmit its payment order at a time and by means reasonably necessary to allow payment to the beneficiary on the payment date or as soon thereafter as is feasible.

(b) Unless otherwise instructed, a receiving bank executing a payment order may (i) use any funds-transfer system if use of that system is reasonable in the circumstances, and (ii) issue a payment order to the beneficiary's bank or to an intermediary bank through which a payment order conforming to the sender's order can expeditiously be issued to the beneficiary's bank if the receiving bank exercises ordinary care in the selection of the intermediary bank. A receiving bank is not required to follow an instruction of the sender designating a funds-transfer system to be used in carrying out the funds transfer if the receiving bank, in good faith, determines that it is not feasible to follow the instruction or that following the instruction would unduly delay completion of the funds transfer.

(c) Unless subsection (a)(2) applies or the receiving bank is otherwise instructed, the bank may execute a payment order by transmitting its payment order by first class mail or by any means reasonable in the circumstances. If the receiving bank is instructed to execute the sender's order by transmitting its payment order by a particular means, the receiving bank may issue its payment order by the means stated or by any means as expeditious as the means stated.

(d) Unless instructed by the sender, (i) the receiving bank may not obtain payment of its charges for services and expenses in connection with the execution of the sender's order by issuing a payment order in an amount equal to the amount of the sender's order less the amount of the charges, and (ii) may not instruct a subsequent receiving bank to obtain payment of its charges in the same manner.

4A-303. ERRONEOUS EXECUTION OF PAYMENT ORDER.

(a) A receiving bank that (i) executes the payment order of the sender by issuing a payment order in an amount greater than the amount of the sender's order, or (ii) issues a payment order in execution of the sender's order and then issues a duplicate order, is entitled to payment of the amount of the sender's order under Section 4A-402(c) if that subsection is otherwise satisfied. The bank is entitled to recover from the beneficiary of the erroneous order the excess payment received to the extent allowed by the law governing mistake and restitution.

(b) A receiving bank that executes the payment order of the sender by issuing a payment order in an amount less than the amount of the sender's order is entitled to payment of the amount of the sender's order under Section 4A-402(c) if (i) that subsection is otherwise satisfied and (ii) the bank corrects its mistake by issuing an additional payment order for the benefit of the beneficiary of the sender's order. If the error is not corrected, the issuer of the erroneous order is entitled to receive or retain payment from the sender of the order it accepted only to the extent of the amount of the erroneous order. This subsection does not apply if the receiving bank executes the sender's payment order by issuing a payment order in an amount less than the amount of the sender's order for the purpose of obtaining payment of its charges for services and expenses pursuant to instruction of the sender.

(c) If a receiving bank executes the payment order of the sender by issuing a payment order to a beneficiary different from the beneficiary of the sender's order and the funds transfer is completed on the basis of that error, the sender of the payment order that was erroneously executed and all previous senders in the funds transfer are not obliged to pay the payment orders they issued. The issuer of the erroneous order is entitled to recover from the beneficiary of the order the payment received to the extent allowed by the law governing mistake and restitution.

4A-304. DUTY OF SENDER TO REPORT ERRONEOUSLY EXECUTED PAYMENT ORDER.

If the sender of a payment order that is erroneously executed as stated in Section 4A-303 receives notification from the receiving bank that the order was executed or that the sender's account was debited with respect to the order, the sender has a duty to exercise ordinary care to determine, on the basis of information available to the sender, that the order was erroneously executed and to notify the bank of the relevant facts within a reasonable time not exceeding 90 days after the notification from the bank was received by the sender. If the sender fails to perform that duty, the bank is not obliged to pay interest on any amount refundable to the sender under Section 4A-402(d) for the period before the bank learns of the execution error. The bank is not entitled to any recovery from the sender on account of a failure by the sender to perform the duty stated in this section.

4A-305. LIABILITY FOR LATE OR IMPROPER EXECUTION OR FAILURE TO EXECUTE PAYMENT ORDER.

(a) If a funds transfer is completed but execution of a payment order by the receiving bank in breach of Section 4A-302 results in delay in payment to the beneficiary, the bank is obliged to pay interest to either the originator or the beneficiary of the funds transfer for the period of delay caused by the improper execution. Except as provided in subsection (c), additional damages are not recoverable.

(b) If execution of a payment order by a receiving bank in breach of Section 4A-302 results in (i) noncompletion of the funds transfer, (ii) failure to use an intermediary bank designated by the originator, or (iii) issuance of a payment order that does not comply with the terms of the payment order of the originator, the bank is liable to the originator for its expenses in the funds transfer and for incidental expenses and interest losses, to the extent not covered by subsection (a), resulting from the improper execution. Except as provided in subsection (c), additional damages are not recoverable.

(c) In addition to the amounts payable under subsections (a) and (b), damages, including consequential damages, are recoverable to the extent provided in an express written agreement of the receiving bank.

(d) If a receiving bank fails to execute a payment order it was obliged by express agreement to execute, the receiving bank is liable to the sender for its expenses in the transaction and for incidental expenses and interest losses resulting from the failure to execute. Additional damages, including consequential damages, are recoverable to the extent provided in an express written agreement of the receiving bank, but are not otherwise recoverable.

(e) Reasonable attorney's fees are recoverable if demand for compensation under subsection (a) or (b) is made and refused before an action is brought on the claim. If a claim is made for breach of an agreement under subsection (d) and the agreement does not provide for damages, reasonable attorney's fees are recoverable if demand for compensation under subsection (d) is made and refused before an action is brought on the claim.

(f) Except as stated in this section, the liability of a receiving bank under subsections (a) and (b) may not be varied by agreement.

PART 4. PAYMENT [Table of Contents]

4A-401. PAYMENT DATE.

"**Payment date**" of a payment order means the day on which the amount of the order is payable to the beneficiary by the beneficiary's bank. The payment date may be determined by instruction of the sender but cannot be earlier than the day the order is received by the beneficiary's bank and, unless otherwise determined, is the day the order is received by the beneficiary's bank.

4A-402. OBLIGATION OF SENDER TO PAY RECEIVING BANK.

(a) This section is subject to Sections 4A-205 and 4A-207.

(b) With respect to a payment order issued to the beneficiary's bank, acceptance of the order by the bank obliges the sender to pay the bank the amount of the order, but payment is not due until the payment date of the order.

(c) This subsection is subject to subsection (e) and to Section 4A-303. With respect to a payment order issued to a receiving bank other than the beneficiary's bank, acceptance of the order by the receiving bank obliges the sender to pay the bank the amount of the sender's order. Payment by the sender is not due until the execution date of the sender's order. The obligation of that sender to pay its payment order is excused if the funds transfer is not completed by acceptance by the beneficiary's bank of a payment order instructing payment to the beneficiary of that sender's payment order.

(d) If the sender of a payment order pays the order and was not obliged to pay all or part of the amount paid, the bank receiving payment is obliged to refund payment to the extent the sender was

not obliged to pay. Except as provided in Sections 4A-204 and 4A-304, interest is payable on the refundable amount from the date of payment.

(e) If a funds transfer is not completed as stated in subsection (c) and an intermediary bank is obliged to refund payment as stated in subsection (d) but is unable to do so because not permitted by applicable law or because the bank suspends payments, a sender in the funds transfer that executed a payment order in compliance with an instruction, as stated in Section 4A-302(a)(1), to route the funds transfer through that intermediary bank is entitled to receive or retain payment from the sender of the payment order that it accepted. The first sender in the funds transfer that issued an instruction requiring routing through that intermediary bank is subrogated to the right of the bank that paid the intermediary bank to refund as stated in subsection (d).

(f) The right of the sender of a payment order to be excused from the obligation to pay the order as stated in subsection (c) or to receive refund under subsection (d) may not be varied by agreement.

4A-403. PAYMENT BY SENDER TO RECEIVING BANK.

(a) Payment of the sender's obligation under Section 4A-402 to pay the receiving bank occurs as follows:

(1) If the sender is a bank, payment occurs when the receiving bank receives final settlement of the obligation through a Federal Reserve Bank or through a funds-transfer system.

(2) If the sender is a bank and the sender (i) credited an account of the receiving bank with the sender, or (ii) caused an account of the receiving bank in another bank to be credited, payment occurs when the credit is withdrawn or, if not withdrawn, at midnight of the day on which the credit is withdrawable and the receiving bank learns of that fact.

(3) If the receiving bank debits an account of the sender with the receiving bank, payment occurs when the debit is made to the extent the debit is covered by a withdrawable credit balance in the account.

(b) If the sender and receiving bank are members of a funds-transfer system that nets obligations multilaterally among participants, the receiving bank receives final settlement when settlement is complete in accordance with the rules of the system. The obligation of the sender to pay the amount of a payment order transmitted through the funds-transfer system may be satisfied, to the extent permitted by the rules of the system, by setting off and applying against the sender's obligation the right of the sender to receive payment from the receiving bank of the amount of any other payment order transmitted to the sender by the receiving bank through the funds-transfer system. The aggregate balance of obligations owed by each sender to each receiving bank in the funds-transfer system may be satisfied, to the extent permitted by the rules of the system, by setting off and applying against that balance the aggregate balance of obligations owed to the sender by other members of the system. The aggregate balance is determined after the right of setoff stated in the second sentence of this subsection has been exercised.

(c) If two banks transmit payment orders to each other under an agreement that settlement of the obligations of each bank to the other under Section 4A-402 will be made at the end of the day or other period, the total amount owed with respect to all orders transmitted by one bank shall be set off against the total amount owed with respect to all orders transmitted by the other bank. To the extent of the setoff, each bank has made payment to the other.

(d) In a case not covered by subsection (a), the time when payment of the sender's obligation under Section 4A-402(b) or 4A-402(c) occurs is governed by applicable principles of law that determine when an obligation is satisfied.

4A-404. OBLIGATION OF BENEFICIARY'S BANK TO PAY AND GIVE NOTICE TO BENEFICIARY.

(a) Subject to Sections 4A-211(e), 4A-405(d), and 4A-405(e), if a beneficiary's bank accepts a payment order, the bank is obliged to pay the amount of the order to the beneficiary of the order. Payment is due on the payment date of the order, but if acceptance occurs on the payment date after the close of the funds-transfer business day of the bank, payment is due on the next funds-transfer business day. If the bank refuses to pay after demand by the beneficiary and receipt of notice of particular circumstances that will give rise to consequential damages as a result of nonpayment, the beneficiary may recover damages resulting from the refusal to pay to the extent the bank had notice of the damages, unless the bank proves that it did not pay because of a reasonable doubt concerning the right of the beneficiary to payment.

(b) If a payment order accepted by the beneficiary's bank instructs payment to an account of the beneficiary, the bank is obliged to notify the beneficiary of receipt of the order before midnight of the next funds-transfer business day following the payment date. If the payment order does not instruct payment to an account of the beneficiary, the bank is required to notify the beneficiary only if notice is

required by the order. Notice may be given by first class mail or any other means reasonable in the circumstances. If the bank fails to give the required notice, the bank is obliged to pay interest to the beneficiary on the amount of the payment order from the day notice should have been given until the day the beneficiary learned of receipt of the payment order by the bank. No other damages are recoverable. Reasonable attorney's fees are also recoverable if demand for interest is made and refused before an action is brought on the claim.

(c) The right of a beneficiary to receive payment and damages as stated in subsection (a) may not be varied by agreement or a funds-transfer system rule. The right of a beneficiary to be notified as stated in subsection (b) may be varied by agreement of the beneficiary or by a funds-transfer system rule if the beneficiary is notified of the rule before initiation of the funds transfer.

4A-405. PAYMENT BY BENEFICIARY'S BANK TO BENEFICIARY.

(a) If the beneficiary's bank credits an account of the beneficiary of a payment order, payment of the bank's obligation under Section 4A-404(a) occurs when and to the extent (i) the beneficiary is notified of the right to withdraw the credit, (ii) the bank lawfully applies the credit to a debt of the beneficiary, or (iii) funds with respect to the order are otherwise made available to the beneficiary by the bank.

(b) If the beneficiary's bank does not credit an account of the beneficiary of a payment order, the time when payment of the bank's obligation under Section 4A-404(a) occurs is governed by principles of law that determine when an obligation is satisfied.

(c) Except as stated in subsections (d) and (e), if the beneficiary's bank pays the beneficiary of a payment order under a condition to payment or agreement of the beneficiary giving the bank the right to recover payment from the beneficiary if the bank does not receive payment of the order, the condition to payment or agreement is not enforceable.

(d) A funds-transfer system rule may provide that payments made to beneficiaries of funds transfers made through the system are provisional until receipt of payment by the beneficiary's bank of the payment order it accepted. A beneficiary's bank that makes a payment that is provisional under the rule is entitled to refund from the beneficiary if (i) the rule requires that both the beneficiary and the originator be given notice of the provisional nature of the payment before the funds transfer is initiated, (ii) the beneficiary, the beneficiary's bank and the originator's bank agreed to be bound by the rule, and (iii) the beneficiary's bank did not receive payment of the payment order that it accepted. If the beneficiary is obliged to refund payment to the beneficiary's bank, acceptance of the payment order by the beneficiary's bank is nullified and no payment by the originator of the funds transfer to the beneficiary occurs under Section 4A-406.

(e) This subsection applies to a funds transfer that includes a payment order transmitted over a funds-transfer system that (i) nets obligations multilaterally among participants, and (ii) has in effect a loss-sharing agreement among participants for the purpose of providing funds necessary to complete settlement of the obligations of one or more participants that do not meet their settlement obligations.

If the beneficiary's bank in the funds transfer accepts a payment order and the system fails to complete settlement pursuant to its rules with respect to any payment order in the funds transfer, (i) the acceptance by the beneficiary's bank is nullified and no person has any right or obligation based on the acceptance, (ii) the beneficiary's bank is entitled to recover payment from the beneficiary, (iii) no payment by the originator to the beneficiary occurs under Section 4A-406, and (iv) subject to Section 4A-402(e), each sender in the funds transfer is excused from its obligation to pay its payment order under Section 4A-402(c) because the funds transfer has not been completed.

4A-406. PAYMENT BY ORIGINATOR TO BENEFICIARY; DISCHARGE OF UNDERLYING OBLIGATION.

(a) Subject to Sections 4A-211(e), 4A-405(d), and 4A-405(e), the originator of a funds transfer pays the beneficiary of the originator's payment order (i) at the time a payment order for the benefit of the beneficiary is accepted by the beneficiary's bank in the funds transfer and (ii) in an amount equal to the amount of the order accepted by the beneficiary's bank, but not more than the amount of the originator's order.

(b) If payment under subsection (a) is made to satisfy an obligation, the obligation is discharged to the same extent discharge would result from payment to the beneficiary of the same amount in money, unless (i) the payment under subsection (a) was made by a means prohibited by the contract of the beneficiary with respect to the obligation, (ii) the beneficiary, within a reasonable time after receiving notice of receipt of the order by the beneficiary's bank, notified the originator of the beneficiary's refusal of the payment, (iii) funds with respect to the order were not withdrawn by the beneficiary or applied to a debt of the beneficiary, and (iv) the beneficiary would suffer a loss that could reasonably have been avoided if payment had been made by a means complying with the contract. If payment by the originator does not result in discharge under this section, the originator is

subrogated to the rights of the beneficiary to receive payment from the beneficiary's bank under Section 4A-404(a).

(c) For the purpose of determining whether discharge of an obligation occurs under subsection (b), if the beneficiary's bank accepts a payment order in an amount equal to the amount of the originator's payment order less charges of one or more receiving banks in the funds transfer, payment to the beneficiary is deemed to be in the amount of the originator's order unless upon demand by the beneficiary the originator does not pay the beneficiary the amount of the deducted charges.

(d) Rights of the originator or of the beneficiary of a funds transfer under this section may be varied only by agreement of the originator and the beneficiary.

PART 5. MISCELLANEOUS PROVISIONS [Table of Contents]

4A-501. VARIATION BY AGREEMENT AND EFFECT OF FUNDS-TRANSFER SYSTEM RULE.

(a) Except as otherwise provided in this Article, the rights and obligations of a party to a funds transfer may be varied by agreement of the affected party.

(b) "**Funds-transfer system rule**" means a rule of an association of banks (i) governing transmission of payment orders by means of a funds-transfer system of the association or rights and obligations with respect to those orders, or (ii) to the extent the rule governs rights and obligations between banks that are parties to a funds transfer in which a Federal Reserve Bank, acting as an intermediary bank, sends a payment order to the beneficiary's bank. Except as otherwise provided in this Article, a funds-transfer system rule governing rights and obligations between participating banks using the system may be effective even if the rule conflicts with this Article and indirectly affects another party to the funds transfer who does not consent to the rule. A funds-transfer system rule may also govern rights and obligations of parties other than participating banks using the system to the extent stated in Sections 4A-404(c), 4A-405(d), and 4A-507(c).

4A-502. CREDITOR PROCESS SERVED ON RECEIVING BANK; SETOFF BY BENEFICIARY'S BANK.

(a) As used in this section, "**creditor process**" means levy, attachment, garnishment, notice of lien, sequestration, or similar process issued by or on behalf of a creditor or other claimant with respect to an account.

(b) This subsection applies to creditor process with respect to an authorized account of the sender of a payment order if the creditor process is served on the receiving bank. For the purpose of determining rights with respect to the creditor process, if the receiving bank accepts the payment order the balance in the authorized account is deemed to be reduced by the amount of the payment order to the extent the bank did not otherwise receive payment of the order, unless the creditor process is served at a time and in a manner affording the bank a reasonable opportunity to act on it before the bank accepts the payment order.

(c) If a beneficiary's bank has received a payment order for payment to the beneficiary's account in the bank, the following rules apply:

(1) The bank may credit the beneficiary's account. The amount credited may be set off against an obligation owed by the beneficiary to the bank or may be applied to satisfy creditor process served on the bank with respect to the account.

(2) The bank may credit the beneficiary's account and allow withdrawal of the amount credited unless creditor process with respect to the account is served at a time and in a manner affording the bank a reasonable opportunity to act to prevent withdrawal.

(3) If creditor process with respect to the beneficiary's account has been served and the bank has had a reasonable opportunity to act on it, the bank may not reject the payment order except for a reason unrelated to the service of process.

(d) Creditor process with respect to a payment by the originator to the beneficiary pursuant to a funds transfer may be served only on the beneficiary's bank with respect to the debt owed by that bank to the beneficiary. Any other bank served with the creditor process is not obliged to act with respect to the process.

4A-503. INJUNCTION OR RESTRAINING ORDER WITH RESPECT TO FUNDS TRANSFER.

For proper cause and in compliance with applicable law, a court may restrain (i) a person from issuing a payment order to initiate a funds transfer, (ii) an originator's bank from executing the payment order of the originator, or (iii) the beneficiary's bank from releasing funds to the beneficiary or the beneficiary from withdrawing the funds. A court may not otherwise restrain a person from issuing a payment order, paying or receiving payment of a payment order, or otherwise acting with respect to a funds transfer.

4A-504. ORDER IN WHICH ITEMS AND PAYMENT ORDERS MAY BE CHARGED TO ACCOUNT; ORDER OF WITHDRAWALS FROM ACCOUNT.

(a) If a receiving bank has received more than one payment order of the sender or one or more payment orders and other items that are payable from the sender's account, the bank may charge the sender's account with respect to the various orders and items in any sequence.

(b) In determining whether a credit to an account has been withdrawn by the holder of the account or applied to a debt of the holder of the account, credits first made to the account are first withdrawn or applied.

4A-505. PRECLUSION OF OBJECTION TO DEBIT OF CUSTOMER'S ACCOUNT.

If a receiving bank has received payment from its customer with respect to a payment order issued in the name of the customer as sender and accepted by the bank, and the customer received notification reasonably identifying the order, the customer is precluded from asserting that the bank is not entitled to retain the payment unless the customer notifies the bank of the customer's objection to the payment within one year after the notification was received by the customer.

4A-506. RATE OF INTEREST.

(a) If, under this Article, a receiving bank is obliged to pay interest with respect to a payment order issued to the bank, the amount payable may be determined (i) by agreement of the sender and receiving bank, or (ii) by a funds-transfer system rule if the payment order is transmitted through a funds-transfer system.

(b) If the amount of interest is not determined by an agreement or rule as stated in subsection (a), the amount is calculated by multiplying the applicable Federal Funds rate by the amount on which interest is payable, and then multiplying the product by the number of days for which interest is payable. The applicable Federal Funds rate is the average of the Federal Funds rates published by the Federal Reserve Bank of New York for each of the days for which interest is payable divided by 360. The Federal Funds rate for any day on which a published rate is not available is the same as the published rate for the next preceding day for which there is a published rate. If a receiving bank that accepted a payment order is required to refund payment to the sender of the order because the funds transfer was not completed, but the failure to complete was not due to any fault by the bank, the interest payable is reduced by a percentage equal to the reserve requirement on deposits of the receiving bank.

4A-507. CHOICE OF LAW.

(a) The following rules apply unless the affected parties otherwise agree or subsection (c) applies:

(1) The rights and obligations between the sender of a payment order and the receiving bank are governed by the law of the jurisdiction in which the receiving bank is located.

(2) The rights and obligations between the beneficiary's bank and the beneficiary are governed by the law of the jurisdiction in which the beneficiary's bank is located.

(3) The issue of when payment is made pursuant to a funds transfer by the originator to the beneficiary is governed by the law of the jurisdiction in which the beneficiary's bank is located.

(b) If the parties described in each paragraph of subsection (a) have made an agreement selecting the law of a particular jurisdiction to govern rights and obligations between each other, the law of that jurisdiction governs those rights and obligations, whether or not the payment order or the funds transfer bears a reasonable relation to that jurisdiction.

(c) A funds-transfer system rule may select the law of a particular jurisdiction to govern (i) rights and obligations between participating banks with respect to payment orders transmitted or processed through the system, or (ii) the rights and obligations of some or all parties to a funds transfer any part of which is carried out by means of the system. A choice of law made pursuant to clause (i) is binding on participating banks.

A choice of law made pursuant to clause (ii) is binding on the originator, other sender, or a receiving bank having notice that the funds-transfer system might be used in the funds transfer and of the choice of law by the system when the originator, other sender, or receiving bank issued or accepted a payment order. The beneficiary of a funds transfer is bound by the choice of law if, when the funds transfer is initiated, the beneficiary has notice that the funds-transfer system might be used in the funds transfer and of the choice of law by the system. The law of a jurisdiction selected pursuant to this subsection may govern, whether or not that law bears a reasonable relation to the matter in issue.

(d) In the event of inconsistency between an agreement under subsection (b) and a choice-of-law rule under subsection (c), the agreement under subsection (b) prevails.

(e) If a funds transfer is made by use of more than one funds-transfer system and there is inconsistency between choice-of-law rules of the systems, the matter in issue is governed by the law of the selected jurisdiction that has the most significant relationship to the matter in issue.

ARTICLE 5 - LETTERS OF CREDIT

5-101. Short Title.

This Article shall be known and may be cited as Uniform Commercial Code-Letters of Credit.

5-102. Definitions.

(a) In this article:

(1) "**Adviser**" means a person who, at the request of the issuer, a confirmer, or another adviser, notifies or requests another adviser to notify the beneficiary that a letter of credit has been issued, confirmed, or amended.

(2) "**Applicant**" means a person at whose request or for whose account a letter of credit is issued. The term includes a person who requests an issuer to issue a letter of credit on behalf of another if the person making the request undertakes an obligation to reimburse the issuer.

(3) "**Beneficiary**" means a person who under the terms of a letter of credit is entitled to have its complying presentation honored. The term includes a person to whom drawing rights have been transferred under a transferable letter of credit.

(4) "**Confirmer**" means a nominated person who undertakes, at the request or with the consent of the issuer, to honor a presentation under a letter of credit issued by another.

(5) "**Dishonor**" of a letter of credit means failure timely to honor or to take an interim action, such as acceptance of a draft, that may be required by the letter of credit.

(6) "**Document**" means a draft or other demand, document of title, investment security, certificate, invoice, or other record, statement, or representation of fact, law, right, or opinion (i) which is presented in a written or other medium permitted by the letter of credit or, unless prohibited by the letter of credit, by the standard practice referred to in Section 5-108(e) and (ii) which is capable of being examined for compliance with the terms and conditions of the letter of credit. A document may not be oral.

(7) "**Good faith**" means honesty in fact in the conduct or transaction concerned.

(8) "**Honor**" of a letter of credit means performance of the issuer's undertaking in the letter of credit to pay or deliver an item of value. Unless the letter of credit otherwise provides, "honor" occurs (i) upon payment,(ii) if the letter of credit provides for acceptance, upon acceptance of a draft and, at maturity, its payment, or(iii) if the letter of credit provides for incurring a deferred obligation, upon incurring the obligation and, at maturity, its performance.

(9) "**Issuer**" means a bank or other person that issues a letter of credit, but does not include an individual who makes an engagement for personal, family, or household purposes.

(10) "**Letter of credit**" means a definite undertaking that satisfies the requirements of Section 5-104 by an issuer to a beneficiary at the request or for the account of an applicant or, in the case of a financial institution, to itself or for its own account, to honor a documentary presentation by payment or delivery of an item of value.

(11) "**Nominated person**" means a person whom the issuer (i) designates or authorizes to pay, accept, negotiate, or otherwise give value under a letter of credit and (ii) undertakes by agreement or custom and practice to reimburse.

(12) "**Presentation**" means delivery of a document to an issuer or nominated person for honor or giving of value under a letter of credit.

(13) "**Presenter**" means a person making a presentation as or on behalf of a beneficiary or nominated person.

(14) "**Record**" means information that is inscribed on a tangible medium, or that is stored in an electronic or other medium and is retrievable in perceivable form.

(15) "**Successor of a beneficiary**" means a person who succeeds to substantially all of the rights of a beneficiary by operation of law, including a corporation with or into which the beneficiary has been merged or consolidated, an administrator, executor, personal representative, trustee in bankruptcy, debtor in possession, liquidator, and receiver.

(b) Definitions in other Articles applying to this article and the sections in which they appear are:

"**Accept**" or "**Acceptance**" Section 3-409

"**Value**" Sections 3-303, 4-211

(c) Article 1 contains certain additional general definitions and principles of construction and interpretation applicable throughout this article.

5-103. Scope.

(a) This article applies to letters of credit and to certain rights and obligations arising out of transactions involving letters of credit.

(b) The statement of a rule in this article does not by itself require, imply, or negate application of the same or a different rule to a situation not provided for, or to a person not specified, in this article.

(c) With the exception of this subsection, subsections (a) and (d), Sections 5-102(a)(9) and (10), 5-106(d), and 5-114(d), and except to the extent prohibited in Sections 1-302 and 5-117(d), the effect of this article may be varied by agreement or by a provision stated or incorporated by reference in an undertaking. A term in an agreement or undertaking generally excusing liability or generally limiting remedies for failure to perform obligations is not sufficient to vary obligations prescribed by this article.

(d) Rights and obligations of an issuer to a beneficiary or a nominated person under a letter of credit are independent of the existence, performance, or nonperformance of a contract or arrangement out of which the letter of credit arises or which underlies it, including contracts or arrangements between the issuer and the applicant and between the applicant and the beneficiary.

5-104. Formal Requirements.

A letter of credit, confirmation, advice, transfer, amendment, or cancellation may be issued in any form that is a record and is authenticated (i) by a signature or (ii) in accordance with the agreement of the parties or the standard practice referred to in Section 5-108(e).

5-105. Consideration.

Consideration is not required to issue, amend, transfer, or cancel a letter of credit, advice, or confirmation.

5-106. Issuance, Amendment, Cancellation, and Duration.

(a) A letter of credit is issued and becomes enforceable according to its terms against the issuer when the issuer sends or otherwise transmits it to the person requested to advise or to the beneficiary. A letter of credit is revocable only if it so provides.

(b) After a letter of credit is issued, rights and obligations of a beneficiary, applicant, confirmer, and issuer are not affected by an amendment or cancellation to which that person has not consented except to the extent the letter of credit provides that it is revocable or that the issuer may amend or cancel the letter of credit without that consent.

(c) If there is no stated expiration date or other provision that determines its duration, a letter of credit expires one year after its stated date of issuance or, if none is stated, after the date on which it is issued.

(d) A letter of credit that states that it is perpetual expires five years after its stated date of issuance, or if none is stated, after the date on which it is issued.

5-107. Confirmer, Nominated Person, and Adviser.

(a) A confirmer is directly obligated on a letter of credit and has the rights and obligations of an issuer to the extent of its confirmation. The confirmer also has rights against and obligations to the issuer as if the issuer were an applicant and the confirmer had issued the letter of credit at the request and for the account of the issuer.

(b) A nominated person who is not a confirmer is not obligated to honor or otherwise give value for a presentation.

(c) A person requested to advise may decline to act as an adviser. An adviser that is not a confirmer is not obligated to honor or give value for a presentation. An adviser undertakes to the issuer and to the beneficiary accurately to advise the terms of the letter of credit, confirmation, amendment, or advice received by that person and undertakes to the beneficiary to check the apparent authenticity of the request to advise. Even if the advice is inaccurate, the letter of credit, confirmation, or amendment is enforceable as issued.

(d) A person who notifies a transferee beneficiary of the terms of a letter of credit, confirmation, amendment, or advice has the rights and obligations of an adviser under subsection (c). The terms in

the notice to the transferee beneficiary may differ from the terms in any notice to the transferor beneficiary to the extent permitted by the letter of credit, confirmation, amendment, or advice received by the person who so notifies.

5-108. Issuer's Rights and Obligations

(a) Except as otherwise provided in Section 5-109, an issuer shall honor a presentation that, as determined by the standard practice referred to in subsection (e), appears on its face strictly to comply with the terms and conditions of the letter of credit. Except as otherwise provided in Section 5-113 and unless otherwise agreed with the applicant, an issuer shall dishonor a presentation that does not appear so to comply.

(b) An issuer has a reasonable time after presentation, but not beyond the end of the seventh business day of the issuer after the day of its receipt of documents:

(1) to honor,

(2) if the letter of credit provides for honor to be completed more than seven business days after presentation, to accept a draft or incur a deferred obligation, or

(3) to give notice to the presenter of discrepancies in the presentation.

(c) Except as otherwise provided in subsection (d), an issuer is precluded from asserting as a basis for dishonor any discrepancy if timely notice is not given, or any discrepancy not stated in the notice if timely notice is given.

(d) Failure to give the notice specified in subsection (b) or to mention fraud, forgery, or expiration in the notice does not preclude the issuer from asserting as a basis for dishonor fraud or forgery as described in Section 5-109(a) or expiration of the letter of credit before presentation.

(e) An issuer shall observe standard practice of financial institutions that regularly issue letters of credit. Determination of the issuer's observance of the standard practice is a matter of interpretation for the court. The court shall offer the parties a reasonable opportunity to present evidence of the standard practice.

(f) An issuer is not responsible for:

(1) the performance or nonperformance of the underlying contract, arrangement, or transaction,

(2) an act or omission of others, or

(3) observance or knowledge of the usage of a particular trade other than the standard practice referred to in subsection (e).

(g) If an undertaking constituting a letter of credit under Section 5-102(a)(10) contains nondocumentary conditions, an issuer shall disregard the nondocumentary conditions and treat them as if they were not stated.

(h) An issuer that has dishonored a presentation shall return the documents or hold them at the disposal of, and send advice to that effect to, the presenter.

(i) An issuer that has honored a presentation as permitted or required by this article:

(1) is entitled to be reimbursed by the applicant in immediately available funds not later than the date of its payment of funds;

(2) takes the documents free of claims of the beneficiary or presenter;

(3) is precluded from asserting a right of recourse on a draft under Sections 3-414 and 3-415;

(4) except as otherwise provided in Sections 5-110 and 5-117, is precluded from restitution of money paid or other value given by mistake to the extent the mistake concerns discrepancies in the documents or tender which are apparent on the face of the presentation; and

(5) is discharged to the extent of its performance under the letter of credit unless the issuer honored a presentation in which a required signature of a beneficiary was forged.

5-109. Fraud and Forgery.

(a) If a presentation is made that appears on its face strictly to comply with the terms and conditions of the letter of credit, but a required document is forged or materially fraudulent, or honor of the presentation would facilitate a material fraud by the beneficiary on the issuer or applicant:

(1) the issuer shall honor the presentation, if honor is demanded by (i) a nominated person who has given value in good faith and without notice of forgery or material fraud, (ii) a confirmer who has honored its confirmation in good faith, (iii) a holder in due course of a draft drawn under the

letter of credit which was taken after acceptance by the issuer or nominated person, or (iv) an assignee of the issuer's or nominated person's deferred obligation that was taken for value and without notice of forgery or material fraud after the obligation was incurred by the issuer or nominated person; and

(2) the issuer, acting in good faith, may honor or dishonor the presentation in any other case.

(b) If an applicant claims that a required document is forged or materially fraudulent or that honor of the presentation would facilitate a material fraud by the beneficiary on the issuer or applicant, a court of competent jurisdiction may temporarily or permanently enjoin the issuer from honoring a presentation or grant similar relief against the issuer or other persons only if the court finds that:

(1) the relief is not prohibited under the law applicable to an accepted draft or deferred obligation incurred by the issuer;

(2) a beneficiary, issuer, or nominated person who may be adversely affected is adequately protected against loss that it may suffer because the relief is granted;

(3) all of the conditions to entitle a person to the relief under the law of this State have been met; and

(4) on the basis of the information submitted to the court, the applicant is more likely than not to succeed under its claim of forgery or material fraud and the person demanding honor does not qualify for protection under subsection (a)(1).

5-110. Warranties.

(a) If its presentation is honored, the beneficiary warrants:

(1) to the issuer, any other person to whom presentation is made, and the applicant that there is no fraud or forgery of the kind described in Section 5-109(a); and

(2) to the applicant that the drawing does not violate any agreement between the applicant and beneficiary or any other agreement intended by them to be augmented by the letter of credit.

(b) The warranties in subsection (a) are in addition to warranties arising under Article 3, 4, 7, and 8 because of the presentation or transfer of documents covered by any of those articles.

5-111. Remedies.

(a) If an issuer wrongfully dishonors or repudiates its obligation to pay money under a letter of credit before presentation, the beneficiary, successor, or nominated person presenting on its own behalf may recover from the issuer the amount that is the subject of the dishonor or repudiation. If the issuer's obligation under the letter of credit is not for the payment of money, the claimant may obtain specific performance or, at the claimant's election, recover an amount equal to the value of performance from the issuer. In either case, the claimant may also recover incidental but not consequential damages. The claimant is not obligated to take action to avoid damages that might be due from the issuer under this subsection. If, although not obligated to do so, the claimant avoids damages, the claimant's recovery from the issuer must be reduced by the amount of damages avoided. The issuer has the burden of proving the amount of damages avoided. In the case of repudiation the claimant need not present any document.

(b) If an issuer wrongfully dishonors a draft or demand presented under a letter of credit or honors a draft or demand in breach of its obligation to the applicant, the applicant may recover damages resulting from the breach, including incidental but not consequential damages, less any amount saved as a result of the breach.

(c) If an adviser or nominated person other than a confirmer breaches an obligation under this article or an issuer breaches an obligation not covered in subsection (a) or (b), a person to whom the obligation is owed may recover damages resulting from the breach, including incidental but not consequential damages, less any amount saved as a result of the breach. To the extent of the confirmation, a confirmer has the liability of an issuer specified in this subsection and subsections (a) and (b).

(d) An issuer, nominated person, or adviser who is found liable under subsection (a), (b), or (c) shall pay interest on the amount owed thereunder from the date of wrongful dishonor or other appropriate date.

(e) Reasonable attorney's fees and other expenses of litigation must be awarded to the prevailing party in an action in which a remedy is sought under this article.

(f) Damages that would otherwise be payable by a party for breach of an obligation under this article may be liquidated by agreement or undertaking, but only in an amount or by a formula that is reasonable in light of the harm anticipated.

5-112. Transfer of Letter of Credit.

(a) Except as otherwise provided in Section 5-113, unless a letter of credit provides that it is transferable, the right of a beneficiary to draw or otherwise demand performance under a letter of credit may not be transferred.

(b) Even if a letter of credit provides that it is transferable, the issuer may refuse to recognize or carry out a transfer if:

(1) the transfer would violate applicable law; or

(2) the transferor or transferee has failed to comply with any requirement stated in the letter of credit or any other requirement relating to transfer imposed by the issuer which is within the standard practice referred to in Section 5-108(e) or is otherwise reasonable under the circumstances.

5-113. Transfer by Operation of Law.

(a) A successor of a beneficiary may consent to amendments, sign and present documents, and receive payment or other items of value in the name of the beneficiary without disclosing its status as a successor.

(b) A successor of a beneficiary may consent to amendments, sign and present documents, and receive payment or other items of value in its own name as the disclosed successor of the beneficiary. Except as otherwise provided in subsection (e), an issuer shall recognize a disclosed successor of a beneficiary as beneficiary in full substitution for its predecessor upon compliance with the requirements for recognition by the issuer of a transfer of drawing rights by operation of law under the standard practice referred to in Section 5-108(e) or, in the absence of such a practice, compliance with other reasonable procedures sufficient to protect the issuer.

(c) An issuer is not obliged to determine whether a purported successor is a successor of a beneficiary or whether the signature of a purported successor is genuine or authorized.

(d) Honor of a purported successor's apparently complying presentation under subsection (a) or (b) has the consequences specified in Section 5-108(i) even if the purported successor is not the successor of a beneficiary. Documents signed in the name of the beneficiary or of a disclosed successor by a person who is neither the beneficiary nor the successor of the beneficiary are forged documents for the purposes of Section 5-109.

(e) An issuer whose rights of reimbursement are not covered by subsection (d) or substantially similar law and any confirmer or nominated person may decline to recognize a presentation under subsection (b).

(f) A beneficiary whose name is changed after the issuance of a letter of credit has the same rights and obligations as a successor of a beneficiary under this section.

5-114. Assignment of Proceeds.

(a) In this section, "proceeds of a letter of credit" means the cash, check, accepted draft, or other item of value paid or delivered upon honor or giving of value by the issuer or any nominated person under the letter of credit. The term does not include a beneficiary's drawing rights or documents presented by the beneficiary.

(b) A beneficiary may assign its right to part or all of the proceeds of a letter of credit. The beneficiary may do so before presentation as a present assignment of its right to receive proceeds contingent upon its compliance with the terms and conditions of the letter of credit.

(c) An issuer or nominated person need not recognize an assignment of proceeds of a letter of credit until it consents to the assignment.

(d) An issuer or nominated person has no obligation to give or withhold its consent to an assignment of proceeds of a letter of credit, but consent may not be unreasonably withheld if the assignee possesses and exhibits the letter of credit and presentation of the letter of credit is a condition to honor.

(e) Rights of a transferee beneficiary or nominated person are independent of the beneficiary's assignment of the proceeds of a letter of credit and are superior to the assignee's right to the proceeds.

(f) Neither the rights recognized by this section between an assignee and an issuer, transferee beneficiary, or nominated person nor the issuer's or nominated person's payment of proceeds to an assignee or a third person affect the rights between the assignee and any person other than the issuer, transferee beneficiary, or nominated person. The mode of creating and perfecting a security interest in or granting an assignment of a beneficiary's rights to proceeds is governed by Article 9 or

other law. Against persons other than the issuer, transferee beneficiary, or nominated person, the rights and obligations arising upon the creation of a security interest or other assignment of a beneficiary's right to proceeds and its perfection are governed by Article 9 or other law.

5-115. Statute of Limitations.

An action to enforce a right or obligation arising under this article must be commenced within one year after the expiration date of the relevant letter of credit or one year after the [claim for relief] [cause of action] accrues, whichever occurs later. A [claim for relief] [cause of action] accrues when the breach occurs, regardless of the aggrieved party's lack of knowledge of the breach.

5-116. Choice of Law and Forum.

(a) The liability of an issuer, nominated person, or adviser for action or omission is governed by the law of the jurisdiction chosen by an agreement in the form of a record signed or otherwise authenticated by the affected parties in the manner provided in Section 5-104 or by a provision in the person's letter of credit, confirmation, or other undertaking. The jurisdiction whose law is chosen need not bear any relation to the transaction.

(b) Unless subsection (a) applies, the liability of an issuer, nominated person, or adviser for action or omission is governed by the law of the jurisdiction in which the person is located. The person is considered to be located at the address indicated in the person's undertaking. If more than one address is indicated, the person is considered to be located at the address from which the person's undertaking was issued. For the purpose of jurisdiction, choice of law, and recognition of interbranch letters of credit, but not enforcement of a judgment, all branches of a bank are considered separate juridical entities and a bank is considered to be located at the place where its relevant branch is considered to be located under this subsection.

(c) Except as otherwise provided in this subsection, the liability of an issuer, nominated person, or adviser is governed by any rules of custom or practice, such as the Uniform Customs and Practice for Documentary Credits, to which the letter of credit, confirmation, or other undertaking is expressly made subject. If (i) this article would govern the liability of an issuer, nominated person, or adviser under subsection (a) or (b), (ii) the relevant undertaking incorporates rules of custom or practice, and (iii) there is conflict between this article and those rules as applied to that undertaking, those rules govern except to the extent of any conflict with the nonvariable provisions specified in Section 5-103(c).

(d) If there is conflict between this article and Article 3, 4, 4A, or 9, this article governs.

(e) The forum for settling disputes arising out of an undertaking within this article may be chosen in the manner and with the binding effect that governing law may be chosen in accordance with subsection (a).

5-117. Subrogation of Issuer, Applicant, and Nominated Person.

(a) An issuer that honors a beneficiary's presentation is subrogated to the rights of the beneficiary to the same extent as if the issuer were a secondary obligor of the underlying obligation owed to the beneficiary and of the applicant to the same extent as if the issuer were the secondary obligor of the underlying obligation owed to the applicant.

(b) An applicant that reimburses an issuer is subrogated to the rights of the issuer against any beneficiary, presenter, or nominated person to the same extent as if the applicant were the secondary obligor of the obligations owed to the issuer and has the rights of subrogation of the issuer to the rights of the beneficiary stated in subsection (a).

(c) A nominated person who pays or gives value against a draft or demand presented under a letter of credit is subrogated to the rights of:

(1) the issuer against the applicant to the same extent as if the nominated person were a secondary obligor of the obligation owed to the issuer by the applicant;

(2) the beneficiary to the same extent as if the nominated person were a secondary obligor of the underlying obligation owed to the beneficiary; and

(3) the applicant to same extent as if the nominated person were a secondary obligor of the underlying obligation owed to the applicant.

(d) Notwithstanding any agreement or term to the contrary, the rights of subrogation stated in subsections (a) and (b) do not arise until the issuer honors the letter of credit or otherwise pays and the rights in subsection (c) do not arise until the nominated person pays or otherwise gives value. Until then, the issuer, nominated person, and the applicant do not derive under this section present or prospective rights forming the basis of a claim, defense, or excuse.

5-118. Security Interest of Issuer or Nominated Person.

(a) An issuer or nominated person has a security interest in a document presented under a letter of credit and any identifiable proceeds of the collateral to the extent that the issuer or nominated person honors or gives value for the presentation.

(b) Subject to subsection (c), as long as and to the extent that an issuer or nominated person has not been reimbursed or has not otherwise recovered the value given with respect to a security interest in a document under subsection (a), the security interest continues and is subject to Article 9, but:

(1) a security agreement is not necessary to make the security interest enforceable under Section 9-203(b)(3);

(2) if the document is presented in a medium other than a written or other tangible medium, the security interest is perfected; and

(3) if the document is presented in a written or other tangible medium and is not a certificated security, chattel paper, a document of title, an instrument, or a letter of credit, so long as the debtor does not have possession of the document, the security interest is perfected and has priority over a conflicting security interest in the document.

TRANSITION PROVISIONS

SECTION [ ]. EFFECTIVE DATE.

This [Act] shall become effective on _____, 199___.

SECTION [ ]. REPEAL.

This [Act] [repeals] [amends] [insert citation to existing Article 5].

SECTION [ ]. APPLICABILITY.

This [Act] applies to a letter of credit that is issued on or after the effective date of this [Act]. This [Act] does not apply to a transaction, event, obligation, or duty arising out of or associated with a letter of credit that was issued before the effective date of this [Act].

SECTION [ ]. SAVINGS CLAUSE.

A transaction arising out of or associated with a letter of credit that was issued before the effective date of this [Act] and the rights, obligations, and interests flowing from that transaction are governed by any statute or other law amended or repealed by this [Act] as if repeal or amendment had not occurred and may be terminated, completed, consummated, or enforced under that statute or other law.

ARTICLE 6 REPEALER OF U.C.C. - BULK TRANSFERS and REVISED ARTICLE 6 BULK SALES

(States to Select One Alternative -- A or B)

ALTERNATIVE A

1. Repeal.

Article 6 and Section 9-111 of the Uniform Commercial Code are hereby repealed, effective _____.

2. Amendment.

1-105(2) of the Uniform Commercial Code is hereby amended to read as follows:

(2) Where one of the following provisions of this Act specifies the applicable law, that provision governs and a contrary agreement is effective only to the extent permitted by the law (including the conflict of laws rules) so specified:

Rights of creditors against sold goods. Section 2-402.

Applicability of the Article on Leases. Sections 2A-105 and 2A-106.

Applicability of the Article on Bank Deposits and Collections. Section 4-102.

Applicability of the Article on Investment Securities. Section 8-106.

Perfection provisions of the Article on Secured Transactions. Section 9-103.

3. Amendment.

Section 2-403(4) of the Uniform Commercial Code is hereby amended to read as follows:

(4) The rights of other purchasers of goods and of lien creditors are governed by the Articles on Secured Transactions (Article 9) and Documents of Title (Article 7).

4. Savings Clause.

Rights and obligations that arose under Article 6 and Section 9-111 of the Uniform Commercial Code before their repeal remain valid and may be enforced as though those statutes had not been repealed.]

Legislative Official Comments: To take account of differences between former Article 9 and revised Article 9, a State that repeals Article 6 after revised Article 9 takes effect must make the following changes to Alternative A. First, inasmuch as revised Article 9 contains no counterpart of former Section 9-111, the reference to that section in Section 1 of the repealer should be deleted, and Section 4 of the repeal bill should allude to former Section 9-111. Second, the last entry in Section 1-105(2) should be amended as shown above in this Appendix.

[END OF ALTERNATIVE A]

ALTERNATIVE B

PART 1. SUBJECT MATTER AND DEFINITIONS

6-101. Short Title.

This Article shall be known and may be cited as Uniform Commercial Code - Bulk Sales.

6-102. Definitions and Index of Definitions.

(1) In this Article, unless the context otherwise requires:

(a) "**Assets**" means the inventory that is the subject of a bulk sale and any tangible and intangible personal property used or held for use primarily in, or arising from, the seller's business and sold in connection with that inventory, but the term does not include:

(i) fixtures (Section 9-102(a)(41)) other than readily removable factory and office machines;

(ii) the lessee's interest in a lease of real property; or

(iii) property to the extent it is generally exempt from creditor process under nonbankruptcy law.

(b) "**Auctioneer**" means a person whom the seller engages to direct, conduct, control, or be responsible for a sale by auction.

(c) "**Bulk sale**" means:

(i) in the case of a sale by auction or a sale or series of sales conducted by a liquidator on the seller's behalf, a sale or series of sales not in the ordinary course of the seller's business of more than half of the seller's inventory, as measured by value on the date of the bulk-sale agreement, if on that date the auctioneer or liquidator has notice, or after reasonable inquiry would have had notice, that the seller will not continue to operate the same or a similar kind of business after the sale or series of sales; and

(ii) in all other cases, a sale not in the ordinary course of the seller's business of more than half the seller's inventory, as measured by value on the date of the bulk-sale agreement, if on that date the buyer has notice, or after reasonable inquiry would have had notice, that the seller will not continue to operate the same or a similar kind of business after the sale.

(d) "**Claim**" means a right to payment from the seller, whether or not the right is reduced to judgment, liquidated, fixed, matured, disputed, secured, legal, or equitable. The term includes costs of collection and attorney's fees only to the extent that the laws of this state permit the holder of the claim to recover them in an action against the obligor.

(e) "**Claimant**" means a person holding a claim incurred in the seller's business other than:

(i) an unsecured and unmatured claim for employment compensation and benefits, including commissions and vacation, severance, and sick-leave pay;

(ii) a claim for injury to an individual or to property, or for breach of warranty, unless:

(A) a right of action for the claim has accrued;

(B) the claim has been asserted against the seller; and

(C) the seller knows the identity of the person asserting the claim and the basis upon which the person has asserted it; and

(States To Select One Alternative)

ALTERNATIVE A

[(iii) a claim for taxes owing to a governmental unit.]

ALTERNATIVE B

[(iii) a claim for taxes owing to a governmental unit, if:

(A) a statute governing the enforcement of the claim permits or requires notice of the bulk sale to be given to the governmental unit in a manner other than by compliance with the requirements of this Article; and

(B) notice is given in accordance with the statute.]

(f) "**Creditor**" means a claimant or other person holding a claim.

(g) (i) "**Date of the bulk sale**" means:

(A) if the sale is by auction or is conducted by a liquidator on the seller's behalf, the date on which more than ten percent of the net proceeds is paid to or for the benefit of the seller; and

(B) in all other cases, the later of the date on which:

(I) more than ten percent of the net contract price is paid to or for the benefit of the seller; or

(II) more than ten percent of the assets, as measured by value, are transferred to the buyer.

(ii) For purposes of this subsection:

(A) Delivery of a negotiable instrument (Section 3-104(1) [sic]) to or for the benefit of the seller in exchange for assets constitutes payment of the contract price pro tanto;

(B) To the extent that the contract price is deposited in an escrow, the contract price is paid to or for the benefit of the seller when the seller acquires the unconditional right to receive the deposit or when the deposit is delivered to the seller or for the benefit of the seller, whichever is earlier; and

(C) An asset is transferred when a person holding an unsecured claim can no longer obtain through judicial proceedings rights to the asset that are superior to those of the buyer arising as a result of the bulk sale. A person holding an unsecured claim can obtain those superior rights to a tangible asset at least until the buyer has an unconditional right, under the bulk-sale agreement, to possess the asset, and a person holding an unsecured claim can obtain those superior rights to an intangible asset at least until the buyer has an unconditional right, under the bulk-sale agreement, to use the asset.

(h) "**Date of the bulk-sale agreement**" means:

(i) in the case of a sale by auction or conducted by a liquidator (subsection (c)(i)), the date on which the seller engages the auctioneer or liquidator; and

(ii) in all other cases, the date on which a bulk-sale agreement becomes enforceable between the buyer and the seller.

(i) "**Debt**" means liability on a claim.

(j) "**Liquidator**" means a person who is regularly engaged in the business of disposing of assets for businesses contemplating liquidation or dissolution.

(k) "**Net contract price**" means the new consideration the buyer is obligated to pay for the assets less:

(i) the amount of any proceeds of the sale of an asset, to the extent the proceeds are applied in partial or total satisfaction of a debt secured by the asset; and

(ii) the amount of any debt to the extent it is secured by a security interest or lien that is enforceable against the asset before and after it has been sold to a buyer. If a debt is secured by an asset and other property of the seller, the amount of the debt secured by a security interest or lien that is enforceable against the asset is determined by multiplying the debt by a fraction, the numerator of which is the value of the new consideration for the asset on the date of the bulk sale and the denominator of which is the value of all property securing the debt on the date of the bulk sale.

(l) "**Net proceeds**" means the new consideration received for assets sold at a sale by auction or a sale conducted by a liquidator on the seller's behalf less:

(i) commissions and reasonable expenses of the sale;

(ii) the amount of any proceeds of the sale of an asset, to the extent the proceeds are applied in partial or total satisfaction of a debt secured by the asset; and

(iii) the amount of any debt to the extent it is secured by a security interest or lien that is enforceable against the asset before and after it has been sold to a buyer. If a debt is secured by an asset and other property of the seller, the amount of the debt secured by a security interest or lien that is enforceable against the asset is determined by multiplying the debt by a fraction, the numerator of which is the value of the new consideration for the asset on the date of the bulk sale and the denominator of which is the value of all property securing the debt on the date of the bulk sale.

(m) A sale is "**in the ordinary course of the seller's business**" if the sale comports with usual or customary practices in the kind of business in which the seller is engaged or with the seller's own usual or customary practices.

(n) "**United States**" includes its territories and possessions and the Commonwealth of Puerto Rico.

(o) "**Value**" means fair market value.

(p) "**Verified**" means signed and sworn to or affirmed.

(2) The following definitions in other Articles apply to this Article:

(a) "**Buyer.**" Section 2-103(1)(a).

(b) "**Equipment.**" Section 9-102(a)(33).

(c) "**Inventory.**" Section 9-102(a)(48).

(d) "**Sale.**" Section 2-106(1).

(e) "**Seller.**" Section 2-103(1)(d).

(3) In addition, Article 1 contains general definitions and principles of construction and interpretation applicable throughout this Article.

6-103. APPLICABILITY OF ARTICLE.

(1) Except as otherwise provided in subsection (3), this Article applies to a bulk sale if:

(a) the seller's principal business is the sale of inventory from stock; and

(b) on the date of the bulk-sale agreement the seller is located in this state or, if the seller is located in a jurisdiction that is not a part of the United States, the seller's major executive office in the United States is in this state.

(2) A seller is deemed to be located at his [or her] place of business. If a seller has more than one place of business, the seller is deemed located at his [or her] chief executive office.

(3) This Article does not apply to:

(a) a transfer made to secure payment or performance of an obligation;

(b) a transfer of collateral to a secured party pursuant to Section 9-609;

(c) a sale of collateral pursuant to Section 9-610;

(d) retention of collateral pursuant to Section 9-620;

(e) a sale of an asset encumbered by a security interest or lien if (i) all the proceeds of the sale are applied in partial or total satisfaction of the debt secured by the security interest or lien or (ii) the security interest or lien is enforceable against the asset after it has been sold to the buyer and the net contract price is zero;

(f) a general assignment for the benefit of creditors or to a subsequent transfer by the assignee; (g)

a sale by an executor, administrator, receiver, trustee in bankruptcy, or any public officer under judicial process;

(h) a sale made in the course of judicial or administrative proceedings for the dissolution or reorganization of an organization;

(i) a sale to a buyer whose principal place of business is in the United States and who:

(i) not earlier than 21 days before the date of the bulk sale, (A) obtains from the seller a verified and dated list of claimants of whom the seller has notice three days before the seller sends or delivers the list to the buyer or (B) conducts a reasonable inquiry to discover the claimants;

(ii) assumes in full the debts owed to claimants of whom the buyer has knowledge on the date the buyer receives the list of claimants from the seller or on the date the buyer completes the reasonable inquiry, as the case may be;

(iii) is not insolvent after the assumption; and

(iv) gives written notice of the assumption not later than 30 days after the date of the bulk sale by sending or delivering a notice to the claimants identified in subparagraph (ii) or by filing a notice in the office of the [Secretary of State];

(j) a sale to a buyer whose principal place of business is in the United States and who:

(i) assumes in full the debts that were incurred in the seller's business before the date of the bulk sale;

(ii) is not insolvent after the assumption; and

(iii) gives written notice of the assumption not later than 30 days after the date of the bulk sale by sending or delivering a notice to each creditor whose debt is assumed or by filing a notice in the office of the [Secretary of State];

(k) a sale to a new organization that is organized to take over and continue the business of the seller and that has its principal place of business in the United States if:

(i) the buyer assumes in full the debts that were incurred in the seller's business before the date of the bulk sale;

(ii) the seller receives nothing from the sale except an interest in the new organization that is subordinate to the claims against the organization arising from the assumption; and

(iii) the buyer gives written notice of the assumption not later than 30 days after the date of the bulk sale by sending or delivering a notice to each creditor whose debt is assumed or by filing a notice in the office of the [Secretary of State];

(l) a sale of assets having:

(i) a value, net of liens and security interests, of less than $10,000. If a debt is secured by assets and other property of the seller, the net value of the assets is determined by subtracting from their value an amount equal to the product of the debt multiplied by a fraction, the numerator of which is the value of the assets on the date of the bulk sale and the denominator of which is the value of all property securing the debt on the date of the bulk sale; or

(ii) a value of more than $25,000,000 on the date of the bulk-sale agreement; or

(m) a sale required by, and made pursuant to, statute.

(4) The notice under subsection (3)(i)(iv) must state: (i) that a sale that may constitute a bulk sale has been or will be made; (ii) the date or prospective date of the bulk sale; (iii) the individual, partnership, or corporate names and the addresses of the seller and buyer; (iv) the address to which inquiries about the sale may be made, if different from the seller's address; and (v) that the buyer has assumed or will assume in full the debts owed to claimants of whom the buyer has knowledge on the date the buyer receives the list of claimants from the seller or completes a reasonable inquiry to discover the claimants.

(5) The notice under subsections (3)(j)(iii) and (3)(k)(iii) must state: (i) that a sale that may constitute a bulk sale has been or will be made; (ii) the date or prospective date of the bulk sale; (iii) the individual, partnership, or corporate names and the addresses of the seller and buyer; (iv) the address to which inquiries about the sale may be made, if different from the seller's address; and (v) that the buyer has assumed or will assume the debts that were incurred in the seller's business before the date of the bulk sale.

(6) For purposes of subsection (3)(l), the value of assets is presumed to be equal to the price the buyer agrees to pay for the assets. However, in a sale by auction or a sale conducted by a liquidator on the seller's behalf, the value of assets is presumed to be the amount the auctioneer or liquidator reasonably estimates the assets will bring at auction or upon liquidation.

6-104. Obligations of Buyer.

(1) In a bulk sale as defined in Section 6-102(1)(c)(ii) the buyer shall:

(a) obtain from the seller a list of all business names and addresses used by the seller within three years before the date the list is sent or delivered to the buyer;

(b) unless excused under subsection (2), obtain from the seller a verified and dated list of claimants of whom the seller has notice three days before the seller sends or delivers the list to the buyer and including, to the extent known by the seller, the address of and the amount claimed by each claimant;

(c) obtain from the seller or prepare a schedule of distribution (Section 6-106(1));

(d) give notice of the bulk sale in accordance with Section 6-105;

(e) unless excused under Section 6-106(4), distribute the net contract price in accordance with the undertakings of the buyer in the schedule of distribution; and

(f) unless excused under subsection (2), make available the list of claimants (subsection (1)(b)) by:

(i) promptly sending or delivering a copy of the list without charge to any claimant whose written request is received by the buyer no later than six months after the date of the bulk sale;

(ii) permitting any claimant to inspect and copy the list at any reasonable hour upon request received by the buyer no later than six months after the date of the bulk sale; or

(iii) filing a copy of the list in the office of the [Secretary of State] no later than the time for giving a notice of the bulk sale (Section 6-105(5)). A list filed in accordance with this subparagraph must state the individual, partnership, or corporate name and a mailing address of the seller.

(2) A buyer who gives notice in accordance with Section 6-105(2) is excused from complying with the requirements of subsections (1)(b) and (1)(f).

6-105. NOTICE TO CLAIMANTS.

(1) Except as otherwise provided in subsection (2), to comply with Section 6-104(1)(d) the buyer shall send or deliver a written notice of the bulk sale to each claimant on the list of claimants (Section 6-104(1)(b)) and to any other claimant of whom the buyer has knowledge at the time the notice of the bulk sale is sent or delivered.

(2) A buyer may comply with Section 6-104(1)(d) by filing a written notice of the bulk sale in the office of the [Secretary of State] if:

(a) on the date of the bulk-sale agreement the seller has 200 or more claimants, exclusive of claimants holding secured or matured claims for employment compensation and benefits, including commissions and vacation, severance, and sick-leave pay; or

(b) the buyer has received a verified statement from the seller stating that, as of the date of the bulk-sale agreement, the number of claimants, exclusive of claimants holding secured or matured claims for employment compensation and benefits, including commissions and vacation, severance, and sick-leave pay, is 200 or more.

(3) The written notice of the bulk sale must be accompanied by a copy of the schedule of distribution (Section 6-106(1)) and state at least:

(a) that the seller and buyer have entered into an agreement for a sale that may constitute a bulk sale under the laws of the State of _____;

(b) the date of the agreement;

(c) the date on or after which more than ten percent of the assets were or will be transferred;

(d) the date on or after which more than ten percent of the net contract price was or will be paid, if the date is not stated in the schedule of distribution;

(e) the name and a mailing address of the seller;

(f) any other business name and address listed by the seller pursuant to Section 6-104(1)(a);

(g) the name of the buyer and an address of the buyer from which information concerning the sale can be obtained;

(h) a statement indicating the type of assets or describing the assets item by item;

(i) the manner in which the buyer will make available the list of claimants (Section 6-104(1)(f)), if applicable; and

(j) if the sale is in total or partial satisfaction of an antecedent debt owed by the seller, the amount of the debt to be satisfied and the name of the person to whom it is owed.

(4) For purposes of subsections (3)(e) and (3)(g), the name of a person is the person's individual, partnership, or corporate name.

(5) The buyer shall give notice of the bulk sale not less than 45 days before the date of the bulk sale and, if the buyer gives notice in accordance with subsection (1), not more than 30 days after obtaining the list of claimants.

(6) A written notice substantially complying with the requirements of subsection (3) is effective even though it contains minor errors that are not seriously misleading.

(7) A form substantially as follows is sufficient to comply with subsection (3):

Notice of Sale

(1) _____, whose address is _____, is described in this notice as the "seller."

(2) _____, whose address is _____, is described in this notice as the "buyer."

(3) The seller has disclosed to the buyer that within the past three years the seller has used other business names, operated at other addresses, or both, as follows: _____.

(4) The seller and the buyer have entered into an agreement dated _____, for a sale that may constitute a bulk sale under the laws of the state of _____.

(5) The date on or after which more than ten percent of the assets that are the subject of the sale were or will be transferred is _____, and [if not stated in the schedule of distribution] the date on or after which more than ten percent of the net contract price was or will be paid is _____.

(6) The following assets are the subject of the sale: _____.

(7) [If applicable] The buyer will make available to claimants of the seller a list of the seller's claimants in the following manner: _____.

(8) [If applicable] The sale is to satisfy $ _____ of an antecedent debt owed by the seller to _____.

(9) A copy of the schedule of distribution of the net contract price accompanies this notice.

[End of Notice]

6-106. Schedule of Distribution.

(1) The seller and buyer shall agree on how the net contract price is to be distributed and set forth their agreement in a written schedule of distribution.

(2) The schedule of distribution may provide for distribution to any person at any time, including distribution of the entire net contract price to the seller.

(3) The buyer's undertakings in the schedule of distribution run only to the seller. However, a buyer who fails to distribute the net contract price in accordance with the buyer's undertakings in the schedule of distribution is liable to a creditor only as provided in Section 6-107(1).

(4) If the buyer undertakes in the schedule of distribution to distribute any part of the net contract price to a person other than the seller, and, after the buyer has given notice in accordance with Section 6-105, some or all of the anticipated net contract price is or becomes unavailable for distribution as a consequence of the buyer's or seller's having complied with an order of court, legal process, statute, or rule of law, the buyer is excused from any obligation arising under this Article or under any contract with the seller to distribute the net contract price in accordance with the buyer's undertakings in the schedule if the buyer:

(a) distributes the net contract price remaining available in accordance with any priorities for payment stated in the schedule of distribution and, to the extent that the price is insufficient to pay all the debts having a given priority, distributes the price pro rata among those debts shown in the schedule as having the same priority;

(b) distributes the net contract price remaining available in accordance with an order of court;

(c) commences a proceeding for interpleader in a court of competent jurisdiction and is discharged from the proceeding; or

(d) reaches a new agreement with the seller for the distribution of the net contract price remaining available, sets forth the new agreement in an amended schedule of distribution, gives notice of the amended schedule, and distributes the net contract price remaining available in accordance with the buyer's undertakings in the amended schedule.

(5) The notice under subsection (4)(d) must identify the buyer and the seller, state the filing number, if any, of the original notice, set forth the amended schedule, and be given in accordance with subsection (1) or (2) of Section 6-105, whichever is applicable, at least 14 days before the buyer distributes any part of the net contract price remaining available.

(6) If the seller undertakes in the schedule of distribution to distribute any part of the net contract price, and, after the buyer has given notice in accordance with Section 6-105, some or all of the anticipated net contract price is or becomes unavailable for distribution as a consequence of the buyer's or seller's having complied with an order of court, legal process, statute, or rule of law, the seller and any person in control of the seller are excused from any obligation arising under this Article or under any agreement with the buyer to distribute the net contract price in accordance with the seller's undertakings in the schedule if the seller:

(a) distributes the net contract price remaining available in accordance with any priorities for payment stated in the schedule of distribution and, to the extent that the price is insufficient to pay all the debts having a given priority, distributes the price pro rata among those debts shown in the schedule as having the same priority;

(b) distributes the net contract price remaining available in accordance with an order of court;

(c) commences a proceeding for interpleader in a court of competent jurisdiction and is discharged from the proceeding; or

(d) prepares a written amended schedule of distribution of the net contract price remaining available for distribution, gives notice of the amended schedule, and distributes the net contract price remaining available in accordance with the amended schedule.

(7) The notice under subsection (6)(d) must identify the buyer and the seller, state the filing number, if any, of the original notice, set forth the amended schedule, and be given in accordance with subsection (1) or (2) of Section 6-105, whichever is applicable, at least 14 days before the seller distributes any part of the net contract price remaining available.

6-107. Liability for Noncompliance.

(1) Except as provided in subsection (3), and subject to the limitation in subsection (4):

(a) a buyer who fails to comply with the requirements of Section 6-104(1)(e) with respect to a creditor is liable to the creditor for damages in the amount of the claim, reduced by any amount that the creditor would not have realized if the buyer had complied; and

(b) a buyer who fails to comply with the requirements of any other subsection of Section 6-104 with respect to a claimant is liable to the claimant for damages in the amount of the claim, reduced by any amount that the claimant would not have realized if the buyer had complied.

(2) In an action under subsection (1), the creditor has the burden of establishing the validity and amount of the claim, and the buyer has the burden of establishing the amount that the creditor would not have realized if the buyer had complied.

(3) A buyer who:

(a) made a good faith and commercially reasonable effort to comply with the requirements of Section 6-104(1) or to exclude the sale from the application of this Article under Section 6-103(3); or

(b) on or after the date of the bulk-sale agreement, but before the date of the bulk sale, held a good faith and commercially reasonable belief that this Article does not apply to the particular sale is not liable to creditors for failure to comply with the requirements of Section 6-104. The buyer has the burden of establishing the good faith and commercial reasonableness of the effort or belief.

(4) In a single bulk sale the cumulative liability of the buyer for failure to comply with the requirements of Section 6-104(1) may not exceed an amount equal to:

(a) if the assets consist only of inventory and equipment, twice the net contract price, less the amount of any part of the net contract price paid to or applied for the benefit of the seller or a creditor; or

(b) if the assets include property other than inventory and equipment, twice the net value of the inventory and equipment less the amount of the portion of any part of the net contract price paid to or applied for the benefit of the seller or a creditor which is allocable to the inventory and equipment.

(5) For the purposes of subsection (4)(b), the "net value" of an asset is the value of the asset less (i) the amount of any proceeds of the sale of an asset, to the extent the proceeds are applied in partial or total satisfaction of a debt secured by the asset and (ii) the amount of any debt to the extent it is secured by a security interest or lien that is enforceable against the asset before and after it has been sold to a buyer. If a debt is secured by an asset and other property of the seller, the amount of the debt secured by a security interest or lien that is enforceable against the asset is determined by multiplying the debt by a fraction, the numerator of which is the value of the asset on the date of the bulk sale and the denominator of which is the value of all property securing the debt on the date of the bulk sale.

The portion of a part of the net contract price paid to or applied for the benefit of the seller or a creditor that is "allocable to the inventory and equipment" is the portion that bears the same ratio to that part of the net contract price as the net value of the inventory and equipment bears to the net value of all of the assets.

(6) A payment made by the buyer to a person to whom the buyer is, or believes he [or she] is, liable under subsection (1) reduces pro tanto the buyer's cumulative liability under subsection (4).

(7) No action may be brought under subsection (1)(b) by or on behalf of a claimant whose claim is unliquidated or contingent.

(8) A buyer's failure to comply with the requirements of Section 6-104(1) does not (i) impair the buyer's rights in or title to the assets, (ii) render the sale ineffective, void, or voidable, (iii) entitle a creditor to more than a single satisfaction of his [or her] claim, or (iv) create liability other than as provided in this Article.

(9) Payment of the buyer's liability under subsection (1) discharges pro tanto the seller's debt to the creditor.

(10) Unless otherwise agreed, a buyer has an immediate right of reimbursement from the seller for any amount paid to a creditor in partial or total satisfaction of the buyer's liability under subsection (1).

(11) If the seller is an organization, a person who is in direct or indirect control of the seller, and who knowingly, intentionally, and without legal justification fails, or causes the seller to fail, to distribute the net contract price in accordance with the schedule of distribution is liable to any creditor to whom the seller undertook to make payment under the schedule for damages caused by the failure.

6-108. Bulk Sales by Auction; Bulk Sales Conducted by Liquidator.

(1) Sections 6-104, 6-105, 6-106, and 6-107 apply to a bulk sale by auction and a bulk sale conducted by a liquidator on the seller's behalf with the following modifications:

(a) "buyer" refers to auctioneer or liquidator, as the case may be;

(b) "net contract price" refers to net proceeds of the auction or net proceeds of the sale, as the case may be;

(c) the written notice required under Section 6-105(3) must be accompanied by a copy of the schedule of distribution (Section 6-106(1)) and state at least:

(i) that the seller and the auctioneer or liquidator have entered into an agreement for auction or liquidation services that may constitute an agreement to make a bulk sale under the laws of the State of _____;

(ii) the date of the agreement;

(iii) the date on or after which the auction began or will begin or the date on or after which the liquidator began or will begin to sell assets on the seller's behalf;

(iv) the date on or after which more than ten percent of the net proceeds of the sale were or will be paid, if the date is not stated in the schedule of distribution;

(v) the name and a mailing address of the seller;

(vi) any other business name and address listed by the seller pursuant to Section 6-104(1)(a);

(vii) the name of the auctioneer or liquidator and an address of the auctioneer or liquidator from which information concerning the sale can be obtained;

(viii) a statement indicating the type of assets or describing the assets item by item;

(ix) the manner in which the auctioneer or liquidator will make available the list of claimants (Section 6-104(1)(f)), if applicable; and

(x) if the sale is in total or partial satisfaction of an antecedent debt owed by the seller, the amount of the debt to be satisfied and the name of the person to whom it is owed; and

(d) in a single bulk sale the cumulative liability of the auctioneer or liquidator for failure to comply with the requirements of this section may not exceed the amount of the net proceeds of the sale allocable to inventory and equipment sold less the amount of the portion of any part of the net proceeds paid to or applied for the benefit of a creditor which is allocable to the inventory and equipment.

(2) A payment made by the auctioneer or liquidator to a person to whom the auctioneer or liquidator is, or believes he [or she] is, liable under this section reduces pro tanto the auctioneer's or liquidator's cumulative liability under subsection (1)(d).

(3) A form substantially as follows is sufficient to comply with subsection (1)(c):

Notice of Sale

(1) _____, whose address is _____, is described in this notice as the "seller."

(2) _____, whose address is _____, is described in this notice as the "auctioneer" or "liquidator."

(3) The seller has disclosed to the auctioneer or liquidator that within the past three years the seller has used other business names, operated at other addresses, or both, as follows: _____.

(4) The seller and the auctioneer or liquidator have entered into an agreement dated _____ for auction or liquidation services that may constitute an agreement to make a bulk sale under the laws of the State of _____.

(5) The date on or after which the auction began or will begin or the date on or after which the liquidator began or will begin to sell assets on the seller's behalf is _____, and [if not stated in the schedule of distribution] the date on or after which more than ten percent of the net proceeds of the sale were or will be paid is _____.

(6) The following assets are the subject of the sale: _____.

(7) [If applicable] The auctioneer or liquidator will make available to claimants of the seller a list of the seller's claimants in the following manner: _____.

(8) [If applicable] The sale is to satisfy $ _____ of an antecedent debt owed by the seller to _____.

(9) A copy of the schedule of distribution of the net proceeds accompanies this notice.

[End of Notice]

(4) A person who buys at a bulk sale by auction or conducted by a liquidator need not comply with the requirements of Section 6-104(1) and is not liable for the failure of an auctioneer or liquidator to comply with the requirements of this section.

6-109. What Constitutes Filing; Duties of Filing Officer; Information From Filing Officer.

(1) Presentation of a notice or list of claimants for filing and tender of the filing fee or acceptance of the notice or list by the filing officer constitutes filing under this Article.

(2) The filing officer shall:

(a) mark each notice or list with a file number and with the date and hour of filing;

(b) hold the notice or list or a copy for public inspection;

(c) index the notice or list according to each name given for the seller and for the buyer; and

(d) note in the index the file number and the addresses of the seller and buyer given in the notice or list.

(3) If the person filing a notice or list furnishes the filing officer with a copy, the filing officer upon request shall note upon the copy the file number and date and hour of the filing of the original and send or deliver the copy to the person.

(4) The fee for filing and indexing and for stamping a copy furnished by the person filing to show the date and place of filing is $ _____ for the first page and $ _____ for each additional page. The fee for indexing each name more than two is $ _____.

(5) Upon request of any person, the filing officer shall issue a certificate showing whether any notice or list with respect to a particular seller or buyer is on file on the date and hour stated in the certificate. If a notice or list is on file, the certificate must give the date and hour of filing of each notice or list and the name and address of each seller, buyer, auctioneer, or liquidator. The fee for the certificate is $ _____ if the request for the certificate is in the standard form prescribed by the [Secretary of State] and otherwise is $ _____. Upon request of any person, the filing officer shall furnish a copy of any filed notice or list for a fee of $ _____.

(6) The filing officer shall keep each notice or list for two years after it is filed.

6-110. Limitation of Actions.

(1) Except as provided in subsection (2), an action under this Article against a buyer, auctioneer, or liquidator must be commenced within one year after the date of the bulk sale.

(2) If the buyer, auctioneer, or liquidator conceals the fact that the sale has occurred, the limitation is tolled and an action under this Article may be commenced within the earlier of (i) one year after the person bringing the action discovers that the sale has occurred or (ii) one year after the person bringing the action should have discovered that the sale has occurred, but no later than two years after the date of the bulk sale. Complete noncompliance with the requirements of this Article does not of itself constitute concealment.

(3) An action under Section 6-107(11) must be commenced within one year after the alleged violation occurs.

ARTICLE 7 - DOCUMENTS OF TITLE

PART 1. GENERAL

7-101. Short Title.

This article may be cited as Uniform Commercial Code-Documents of Title.

7-102. Definitions and Index of Definitions.

(a) In this Article, unless the context otherwise requires:

(1) "**Bailee**" means a person that by a warehouse receipt, bill of lading, or other document of title acknowledges possession of goods and contracts to deliver them.

(2) "**Carrier**" means a person that issues a bill of lading.

(3) "**Consignee**" means a person named in a bill of lading to which or to whose order the bill promises delivery.

(4) "**Consignor**" means a person named in a bill of lading as the person from which the goods have been received for shipment.

(5) "**Delivery order**" means a record that contains an order to deliver goods directed to a warehouse, carrier, or other person that in the ordinary course of business issues warehouse receipts or bills of lading.

(6) "**Good faith**" means honesty in fact and the observance of reasonable commercial standards of fair dealing.

(7) "**Goods**" means all things that are treated as movable for the purposes of a contract for storage or transportation.

(8) "**Issuer**" means a bailee that issues a document of title or, in the case of an unaccepted delivery order, the person that orders the possessor of goods to deliver. The term includes a person for which an agent or employee purports to act in issuing a document if the agent or employee has real or apparent authority to issue documents, even if the issuer did not receive any goods, the goods were misdescribed, or in any other respect the agent or employee violated the issuer's instructions.

(9) "**Person entitled under the document**" means the holder, in the case of a negotiable document of title, or the person to which delivery of the goods is to be made by the terms of, or pursuant to instructions in a record under, a nonnegotiable document of title.

(10) "**Record**" means information that is inscribed on a tangible medium or that is stored in an electronic or other medium and is retrievable in perceivable form.

(11) "**Sign**" means, with present intent to authenticate or adopt a record:

(A) to execute or adopt a tangible symbol; or

(B) to attach to or logically associate with the record an electronic sound, symbol, or process.

(12) "**Shipper**" means a person that enters into a contract of transportation with a carrier.

(13) "**Warehouse**" means a person engaged in the business of storing goods for hire.

(b) Definitions in other articles applying to this article and the sections in which they appear are:

(1) "**Contract for sale**", Section 2-106.

(2) "**Lessee in ordinary course of business**", Section 2A-103.

(3) "**Receipt**" of goods, Section 2-103.

(c) In addition, Article 1 contains general definitions and principles of construction and interpretation applicable throughout this article.

7-103. Relation of Article to Treaty or Statute.

(a) This article is subject to any treaty or statute of the United States or a regulatory statute of this State to the extent the treaty, statute, or regulatory statute is applicable.

(b) This article does not repeal or modify any law prescribing the form or contents of a document of title or the services or facilities to be afforded by a bailee, or otherwise regulating a bailee's businesses in respects not specifically treated in this article. However, violation of these laws does not affect the status of a document of title that otherwise complies with the definition of a document of title.

(c) This [Act] modifies, limits, and supersedes the federal Electronic Signatures in Global and National Commerce Act (15 U.S.C. Section 7001, et. seq.) but does not modify, limit, or supersede Section 101(c) of that act (15 U.S.C. Section 7001(c)) or authorize electronic delivery of any of the notices described in Section 103(b) of that act (15 U.S.C. Section 7003(b)).

(d) To the extent there is a conflict between the Uniform Electronic Transactions Act and this article, this article governs.

7-104. Negotiable and Nonnegotiable Document of Title.

(a) A document of title is negotiable if by its terms the goods are to be delivered to bearer or to the order of a named person.

(b) A document of title other than one described in subsection (a) is nonnegotiable. A bill of lading that states that the goods are consigned to a named person is not made negotiable by a provision that the goods are to be delivered only against an order in a record signed by the same or another named person.

(c) A document of title is nonnegotiable if, at the time it is issued, the document has a conspicuous legend, however expressed, that it is nonnegotiable.

7-105. Reissuance in Alternative Medium.

(a) Upon request of a person entitled under an electronic document of title, the issuer of the electronic document may issue a tangible document of title as a substitute for the electronic document if:

(1) the person entitled under the electronic document surrenders control of the document to the issuer; and

(2) the tangible document when issued contains a statement that it is issued in substitution for the electronic document.

(b) Upon issuance of a tangible document of title in substitution for an electronic document of title in accordance with subsection (a):

(1) the electronic document ceases to have any effect or validity; and

(2) the person that procured issuance of the tangible document warrants to all subsequent persons entitled under the tangible document that the warrantor was a person entitled under the electronic document when the warrantor surrendered control of the electronic document to the issuer.

(c) Upon request of a person entitled under a tangible document of title, the issuer of the tangible document may issue an electronic document of title as a substitute for the tangible document if:

(1) the person entitled under the tangible document surrenders possession of the document to the issuer; and

(2) the electronic document when issued contains a statement that it is issued in substitution for the tangible document.

(d) Upon issuance of the electronic document of title in substitution for a tangible document of title in accordance with subsection (c):

(1) the tangible document ceases to have any effect or validity; and

(2) the person that procured issuance of the electronic document warrants to all subsequent persons entitled under the electronic document that the warrantor was a person entitled under the tangible document when the warrantor surrendered possession of the tangible document to the issuer.

7-106. Control of Electronic Document of Title.

(a) A person has control of an electronic document of title if a system employed for evidencing the transfer of interests in the electronic document reliably establishes that person as the person to which the electronic document was issued or transferred.

(b) A system satisfies subsection (a), and a person is deemed to have control of an electronic document of title, if the document is created, stored, and assigned in such a manner that:

(1) a single authoritative copy of the document exists which is unique, identifiable, and, except as otherwise provided in paragraphs (4), (5), and (6), unalterable;

(2) the authoritative copy identifies the person asserting control as:

(A) the person to which the document was issued; or

(B) if the authoritative copy indicates that the document has been transferred, the person to which the document was most recently transferred;

(3) the authoritative copy is communicated to and maintained by the person asserting control or its designated custodian;

(4) copies or amendments that add or change an identified assignee of the authoritative copy can be made only with the consent of the person asserting control;

(5) each copy of the authoritative copy and any copy of a copy is readily identifiable as a copy that is not the authoritative copy; and

(6) any amendment of the authoritative copy is readily identifiable as authorized or unauthorized.

PART 2. WAREHOUSE RECEIPTS: SPECIAL PROVISIONS [Table of Contents]

7-201. Person That May Issue a Warehouse Receipt; Storage Under Bond.

(a) A warehouse receipt may be issued by any warehouse.

(b) If goods, including distilled spirits and agricultural commodities, are stored under a statute requiring a bond against withdrawal or a license for the issuance of receipts in the nature of warehouse receipts, a receipt issued for the goods is deemed to be a warehouse receipt even if issued by a person that is the owner of the goods and is not a warehouse.

7-202. Form of Warehouse Receipt.

(a) A warehouse receipt need not be in any particular form.

(b) Unless a warehouse receipt provides for each of the following, the warehouse is liable for damages caused to a person injured by its omission:

(1) the location of the warehouse facility where the goods are stored;

(2) the date of issue of the receipt;

(3) the unique identification code of the receipt;

(4) a statement whether the goods received will be delivered to the bearer, to a named person, or to a named person or its order;

(5) the rate of storage and handling charges, but if goods are stored under a field warehousing arrangement, a statement of that fact is sufficient on a nonnegotiable receipt;

(6) a description of the goods or the packages containing them;

(7) the signature of the warehouse or its agent;

(8) if the receipt is issued for goods that the warehouse owns, either solely, jointly, or in common with others, the fact of that ownership; and

(9) a statement of the amount of advances made and of liabilities incurred for which the warehouse claims a lien or security interest, but if the precise amount of advances made or of liabilities incurred is, at the time of the issue of the receipt, unknown to the warehouse or to its agent that issued the receipt, a statement of the fact that advances have been made or liabilities incurred and the purpose of the advances or liabilities is sufficient.

(c) A warehouse may insert in its receipt any terms that are not contrary to [the Uniform Commercial Code] and do not impair its obligation of delivery under Section 7-403 or its duty of care under Section 7-204. Any contrary provisions are ineffective.

7-203. Liability for Nonreceipt or Misdescription.

A party to or purchaser for value in good faith of a document of title, other than a bill of lading, that relies upon the description of the goods in the document may recover from the issuer damages caused by the nonreceipt or misdescription of the goods, except to the extent that:

(1) the document conspicuously indicates that the issuer does not know whether all or part of the goods in fact were received or conform to the description, such as a case in which the description is in terms of marks or labels or kind, quantity, or condition, or the receipt or description is qualified by "contents, condition, and quality unknown", "said to contain", or words of similar import, if the indication is true; or

(2) the party or purchaser otherwise has notice of the nonreceipt or misdescription.

7-204. Duty of Care; Contractual Limitation of Warehouse's Liability.

(a) A warehouse is liable for damages for loss of or injury to the goods caused by its failure to exercise care with regard to the goods that a reasonably careful person would exercise under similar circumstances. However, unless otherwise agreed, the warehouse is not liable for damages that could not have been avoided by the exercise of that care.

(b) Damages may be limited by a term in the warehouse receipt or storage agreement limiting the amount of liability in case of loss or damage beyond which the warehouse is not liable. Such a limitation is not effective with respect to the warehouse's liability for conversion to its own use. The warehouse's liability, on request of the bailor in a record at the time of signing such storage agreement or within a reasonable time after receipt of the warehouse receipt, may be increased on part or all of the goods covered by the storage agreement or the warehouse receipt. In this event, increased rates may be charged based on an increased valuation of the goods.

(c) Reasonable provisions as to the time and manner of presenting claims and commencing actions based on the bailment may be included in the warehouse receipt or storage agreement.

(d) This section does not impair or repeal [Insert reference to any statute that imposes a higher responsibility upon the warehouse or invalidates contractual limitations that would be permissible under this Article.]

7-205. Title Under Warehouse Receipt Defeated in Certain Cases.

A buyer in ordinary course of business of fungible goods goods and delivered by a warehouse that is also in the business of buying and selling such goods takes the goods free of any claim under a warehouse receipt even if the receipt is negotiable and has been duly negotiated.

7-206. Termination of Storage at Warehouse's Option.

(a) A warehouse, by giving notice to the person on whose account the goods are held and any other person known to claim an interest in the goods, may require payment of any charges and removal of the goods from the warehouse at the termination of the period of storage fixed by the document of title or, if a period is not fixed, within a stated period not less than 30 days after the warehouse gives notice. If the goods are not removed before the date specified in the notice, the warehouse may sell them pursuant to Section 7-210.

(b) If a warehouse in good faith believes that goods are about to deteriorate or decline in value to less than the amount of its lien within the time provided in subsection (a) and Section 7-210, the warehouse may specify in the notice given under subsection (a) any reasonable shorter time for removal of the goods and, if the goods are not removed, may sell them at public sale held not less than one week after a single advertisement or posting.

(c) If, as a result of a quality or condition of the goods of which the warehouse did not have notice at the time of deposit, the goods are a hazard to other property, the warehouse facilities, or other persons, the warehouse may sell the goods at public or private sale without advertisement or posting

on reasonable notification to all persons known to claim an interest in the goods. If the warehouse, after a reasonable effort, is unable to sell the goods, it may dispose of them in any lawful manner and does not incur liability by reason of that disposition.

(d) A warehouse shall deliver the goods to any person entitled to them under this article upon due demand made at any time before sale or other disposition under this section.

(e) A warehouse may satisfy its lien from the proceeds of any sale or disposition under this section but shall hold the balance for delivery on the demand of any person to which the warehouse would have been bound to deliver the goods.

7-207. Goods Must Be Kept Separate; Fungible Goods.

(a) Unless the warehouse receipt provides otherwise, a warehouse shall keep separate the goods covered by each receipt so as to permit at all times identification and delivery of those goods. However, different lots of fungible goods may be commingled.

(b) If different lots of fungible goods are commingled, the good are owned in common by the persons entitled thereto and the warehouse is severally liable to each owner for that owner's share. If, because of overissue, a mass of fungible goods is insufficient to meet all the receipts the warehouse has issued against it, the persons entitled include all holders to which overissued receipts have been duly negotiated.

7-208. Altered Warehouse Receipts.

If a blank in a negotiable tangible warehouse receipt has been filled in without authority, a good faith purchaser for value and without notice of the lack of authority may treat the insertion as authorized. Any other unauthorized alteration leaves any tangible or electronic warehouse receipt enforceable against the issuer according to its original tenor.

7-209. Lien of Warehouse.

(a) A warehouse has a lien against the bailor on the goods covered by a warehouse receipt or storage agreement or on the proceeds thereof in its possession for charges for storage or transportation, including demurrage and terminal charges, insurance, labor, or other charges, present or future, in relation to the goods, and for expenses necessary for preservation of the goods or reasonably incurred in their sale pursuant to law.

If the person on whose account the goods are held is liable for similar charges or expenses in relation to other goods whenever deposited and it is stated in the warehouse receipt or storage agreement that a lien is claimed for charges and expenses in relation to other goods, the warehouse also has a lien against the goods covered by the warehouse receipt or storage agreement or on the proceeds thereof in its possession for those charges and expenses, whether or not the other goods have been delivered by the warehouse. However, as against a person to which a negotiable warehouse receipt is duly negotiated, a warehouse's lien is limited to charges in an amount or at a rate specified in the warehouse receipt or, if no charges are so specified, to a reasonable charge for storage of the specific goods covered by the receipt subsequent to the date of the receipt.

(b) The warehouse may also reserve a security interest under Article 9 against the bailor for the maximum amount specified on the receipt for charges other than those specified in subsection (a), such as for money advanced and interest. A security interest is governed by Article 9.

(c) A warehouse's lien for charges and expenses under subsection (a) or a security interest under subsection (b) is also effective against any person that so entrusted the bailor with possession of the goods that a pledge of them by the bailor to a good faith purchaser for value would have been valid. However, the lien or security interest is not effective against a person that before issuance of a document of title had a legal interest or a perfected security interest in the goods and that did not:

(1) deliver or entrust the goods or any document covering the goods to the bailor or the bailor's nominee with actual or apparent authority to ship, store, or sell; or with power to obtain delivery under Section 7-403; or with power of disposition under Sections 2-403, 2A-304(2), 2A-305(2) or 9-320 or other statute or rule of law; or

(2) acquiesce in the procurement by the bailor or its nominee of any document.

(d) A warehouse's lien on household goods for charges and expenses in relation to the goods under subsection (a) is also effective against all persons if the depositor was the legal possessor of the goods at the time of deposit. In this subsection, "household goods" means furniture, furnishings, or personal effects used by the depositor in a dwelling.

(e) A warehouse loses its lien on any goods that it voluntarily delivers or unjustifiably refuses to deliver.

7-210. Enforcement of Warehouse's Lien.

(a) Except as otherwise provided in subsection (b), a warehouse's lien may be enforced by public or private sale of the goods, in bulk or in packages, at any time or place and on any terms that are commercially reasonable, after notifying all persons known to claim an interest in the goods. The notification must include a statement of the amount due, the nature of the proposed sale, and the time and place of any public sale. The fact that a better price could have been obtained by a sale at a different time or in a different method from that selected by the warehouse is not of itself sufficient to establish that the sale was not made in a commercially reasonable manner.

The warehouse has sold in a commercially reasonable manner if the warehouse sells the goods in the usual manner in any recognized market therefor, sells at the price current in that market at the time of the sale, or has otherwise sold in conformity with commercially reasonable practices among dealers in the type of goods sold. A sale of more goods than apparently necessary to be offered to ensure satisfaction of the obligation is not commercially reasonable, except in cases covered by the preceding sentence.

(b) A warehouse's lien on goods, other than goods stored by a merchant in the course of its business, may be enforced only if the following requirements are satisfied:

(1) All persons known to claim an interest in the goods must be notified.

(2) The notification must include an itemized statement of the claim, a description of the goods subject to the lien, a demand for payment within a specified time not less than 10 days after receipt of the notification, and a conspicuous statement that unless the claim is paid within that time the goods will be advertised for sale and sold by auction at a specified time and place.

(3) The sale must conform to the terms of the notification.

(4) The sale must be held at the nearest suitable place to where the goods are held or stored.

(5) After the expiration of the time given in the notification, an advertisement of the sale must be published once a week for two weeks consecutively in a newspaper of general circulation where the sale is to be held. The advertisement must include a description of the goods, the name of the person on whose account the goods are being held, and the time and place of the sale. The sale must take place at least 15 days after the first publication. If there is no newspaper of general circulation where the sale is to be held, the advertisement must be posted at least 10 days before the sale in not less than six conspicuous places in the neighborhood of the proposed sale.

(c) Before any sale pursuant to this section, any person claiming a right in the goods may pay the amount necessary to satisfy the lien and the reasonable expenses incurred in complying with this section. In that event, the goods may not be sold but must be retained by the warehouse subject to the terms of the receipt and this article.

(d) A warehouse may buy at any public sale held pursuant to this section.

(e) A purchaser in good faith of goods sold to enforce a warehouse's lien takes the goods free of any rights of persons against which the lien was valid, despite the warehouse's noncompliance with this section.

(f) A warehouse may satisfy its lien from the proceeds of any sale pursuant to this section but shall hold the balance, if any, for delivery on demand to any person to which the warehouse would have been bound to deliver the goods.

(g) The rights provided by this section are in addition to all other rights allowed by law to a creditor against a debtor.

(h) If a lien is on goods stored by a merchant in the course of its business, the lien may be enforced in accordance with subsection (a) or (b).

(i) A warehouse is liable for damages caused by failure to comply with the requirements for sale under this section and, in case of willful violation, is liable for conversion.

PART 3. BILLS OF LADING: SPECIAL PROVISIONS [Table of Contents]

7-301. Liability for Non-receipt or Misdescription; "Said to Contain"; "Shipper's Load and Count"; Improper Handling.

(a) A consignee of a nonnegotiable bill of lading which has given value in good faith, or a holder to which a negotiable bill has been duly negotiated, relying upon the description of the goods in the bill or upon the date shown in the bill, may recover from the issuer damages caused by the misdating of the bill or the nonreceipt or misdescription of the goods, except to the extent that the document of title indicates that the issuer does not know whether any part or all of the goods in fact were received or conform to the description, such as in a case in which the description is in terms of marks or labels

or kind, quantity, or condition or the receipt or description is qualified by "contents or condition of contents of packages unknown", "said to contain", "shipper's weight, load and count," or words of similar import, if that indication is true.

(b) If goods are loaded by the issuer of the bill of lading, the issuer shall count the packages of goods if shipped in packages and ascertain the kind and quantity if shipped in bulk and words such as "shipper's weight, load and count," or words of similar import indicating that the description was made by the shipper are ineffective except as to goods concealed by packages.

(c) If bulk goods are loaded by a shipper that makes available to the issuer of the bill of lading adequate facilities for weighing those goods, the issuer shall ascertain the kind and quantity within a reasonable time after receiving the shipper's request in a record to do so. In that case, "shipper's weight" or words of similar import are ineffective.

(d) The issuer, by including in the bill of lading the words "shipper's weight, load and count," or words of similar import, may indicate that the goods were loaded by the shipper, and, if that statement is true, the issuer is not liable for damages caused by the improper loading. However, omission of such words does not imply liability for damages caused by improper loading.

(e) A shipper guarantees to the issuer the accuracy at the time of shipment of the description, marks, labels, number, kind, quantity, condition, and weight, as furnished by the shipper, and the shipper shall indemnify the issuer against damage caused by inaccuracies in those particulars. This right of the issuer to that indemnity does not limit its responsibility or liability under the contract of carriage to any person other than the shipper.

7-302. Through Bills of Lading and Similar Documents of Title.

(a) The issuer of a through bill of lading or other document of title embodying an undertaking to be performed in part by a person acting as its agent or by a performing carrier is liable to any person entitled to recover on the document for any breach by the other person or the performing carrier of its obligation under the document. However, to the extent that the bill covers an undertaking to be performed overseas or in territory not contiguous to the continental United States or an undertaking including matters other than transportation, this liability for breach by the other person or the performing carrier may be varied by agreement of the parties.

(b) If goods covered by a through bill of lading or other document of title embodying an undertaking to be performed in part by a person other than the issuer are received by that person, the person is subject, with respect to its own performance while the goods are in its possession, to the obligation of the issuer. The person's obligation is discharged by delivery of the goods to another person pursuant to the document and does not include liability for breach by any other person or by the issuer.

(c) The issuer of a through bill of lading or other document of title described in subsection (a) is entitled to recover from the performing carrier, or other person in possession of the goods when the breach of the obligation under the document occurred:

(1) the amount it may be required to pay to any person entitled to recover on the document for the breach, as may be evidenced by any receipt, judgment, or transcript of judgment, and;

(2) the amount of any expense reasonably incurred by the issuer in defending any action commenced by any person entitled to recover on the document for the breach.

7-303. Diversion; Reconsignment; Change of Instructions.

(a) Unless the bill of lading otherwise provides, a carrier may deliver the goods to a person or destination other than that stated in the bill or may otherwise dispose of the goods, without liability for misdelivery, on instructions from:

(1) the holder of a negotiable bill;

(2) the consignor on a nonnegotiable bill even if the consignee has given contrary instructions;

(3) the consignee on a nonnegotiable bill in the absence of contrary instructions from the consignor, if the goods have arrived at the billed destination or if the consignee is in possession of the tangible bill or in control of the electronic bill; or

(4) the consignee on a nonnegotiable bill, if the consignee is entitled as against the consignor to dispose of the goods.

(b) Unless instructions described in subsection (a) are included in a negotiable bill of lading, a person to which the bill is duly negotiated may hold the bailee according to the original terms.

7-304. Tangible Bills of Lading in a Set.

(a) Except as customary in international transportation, a tangible bill of lading may not be issued in a set of parts. The issuer is liable for damages caused by violation of this subsection.

(b) If a tangible bill of lading is lawfully issued in a set of parts, each of which contains an identification code and is expressed to be valid only if the goods have not been delivered against any other part, the whole of the parts constitutes one bill.

(c) If a tangible negotiable bill of lading is lawfully issued in a set of parts and different parts are negotiated to different persons, the title of the holder to which the first due negotiation is made prevails as to both the document of title and the goods even if any later holder may have received the goods from the carrier in good faith and discharged the carrier's obligation by surrendering its part.

(d) A person that negotiates or transfers a single part of a tangible bill of lading issued in a set is liable to holders of that part as if it were the whole set.

(e) The bailee is obliged to deliver in accordance with Part 4 against the first presented part of a tangible bill of lading lawfully issued in a set. Delivery in this manner discharges the bailee's obligation on the whole bill.

7-305. Destination Bills.

(a) Instead of issuing a bill of lading to the consignor at the place of shipment, a carrier, at the request of the consignor, may procure the bill to be issued at destination or at any other place designated in the request.

(b) Upon request of any person entitled as against a carrier to control the goods while in transit and on surrender of possession or control of any outstanding bill of lading or other receipt covering the goods, the issuer, subject to Section 7-105, may procure a substitute bill to be issued at any place designated in the request.

7-306. Altered Bills of Lading.

An unauthorized alteration or filling in of a blank in a bill of lading leaves the bill enforceable according to its original tenor.

7-307. Lien of Carrier.

(a) A carrier has a lien on the goods covered by a bill of lading or on the proceeds thereof in its possession for charges after the date of the carrier's receipt of the goods for storage or transportation, including demurrage and terminal charges, and for expenses necessary for preservation of the goods incident to their transportation or reasonably incurred in their sale pursuant to law. However, against a purchaser for value of a negotiable bill of lading, a carrier's lien is limited to charges stated in the bill or the applicable tariffs or, if no charges are stated, a reasonable charge.

(b) A lien for charges and expenses under subsection (a) on goods that the carrier was required by law to receive for transportation is effective against the consignor or any person entitled to the goods unless the carrier had notice that the consignor lacked authority to subject the goods to those charges and expenses. Any other lien under subsection (a) is effective against the consignor and any person that permitted the bailor to have control or possession of the goods unless the carrier had notice that the bailor lacked authority.

(c) A carrier loses its lien on any goods that it voluntarily delivers or unjustifiably refuses to deliver.

7-308. Enforcement of Carrier's Lien.

(a) A carrier's lien on goods may be enforced by public or private sale of the goods, in bulk or in packages, at any time or place and on any terms that are commercially reasonable, after notifying all persons known to claim an interest in the goods. The notification must include a statement of the amount due, the nature of the proposed sale, and the time and place of any public sale. The fact that a better price could have been obtained by a sale at a different time or in a different method from that selected by the carrier is not of itself sufficient to establish that the sale was not made in a commercially reasonable manner.

The carrier has sold goods in a commercially reasonable manner if the carrier sells the goods in the usual manner in any recognized market therefor, sells at the price current in that market at the time of the sale, or has otherwise sold in conformity with commercially reasonable practices among dealers in the type of goods sold. A sale of more goods than apparently necessary to be offered to ensure satisfaction of the obligation is not commercially reasonable, except in cases covered by the preceding sentence.

(b) Before any sale pursuant to this section, any person claiming a right in the goods may pay the amount necessary to satisfy the lien and the reasonable expenses incurred in complying with this

section. In that event, the goods may not be sold but must be retained by the carrier, subject to the terms of the bill of lading and this article.

(c) A carrier may buy at any public sale pursuant to this section.

(d) A purchaser in good faith of goods sold to enforce a carrier's lien takes the goods free of any rights of persons against which the lien was valid, despite the carrier's noncompliance with this section.

(e) A carrier may satisfy its lien from the proceeds of any sale pursuant to this section but shall hold the balance, if any, for delivery on demand to any person to which the carrier would have been bound to deliver the goods.

(f) The rights provided by this section are in addition to all other rights allowed by law to a creditor against a debtor.

(g) A carrier's lien may be enforced pursuant to either subsection (a) or the procedure set forth in Section 7-210(b).

(h) A carrier is liable for damages caused by failure to comply with the requirements for sale under this section and, in case of willful violation, is liable for conversion.

7-309. Duty of Care; Contractual Limitation of Carrier's Liability.

(a) A carrier that issues a bill of lading, whether negotiable or nonnegotiable, shall exercise the degree of care in relation to the goods which a reasonably careful person would exercise under similar circumstances. This subsection does not affect any statute, regulation, or rule of law that imposes liability upon a common carrier for damages not caused by its negligence.

(b) Damages may be limited by a term in the bill of lading or in a transportation agreement that the carrier's liability may not exceed a value stated in the bill or transportation agreement if the carrier's rates are dependent upon value and the consignor is afforded an opportunity to declare a higher value and the consignor is advised of the opportunity. However, such a limitation is not effective with respect to the carrier's liability for conversion to its own use.

(c) Reasonable provisions as to the time and manner of presenting claims and commencing actions based on the shipment may be included in a bill of lading or a transportation agreement.

PART 4. WAREHOUSE RECEIPTS AND BILLS OF LADING: GENERAL OBLIGATIONS [Table of Contents]

7-401. Irregularities in Issue of Receipt or Bill or Conduct of Issuer.

The obligations imposed by this article on an issuer apply to a document of title even if:

(1) the document does not comply with the requirements of this article or of any other statute, rule, or regulation regarding its issue, form, or content;

(2) the issuer violated laws regulating the conduct of its business;

(3) the goods covered by the document were owned by the bailee when the document was issued; or

(4) the person issuing the document is not a warehouse but the document purports to be a warehouse receipt.

7-402. Duplicate Document of Title; Overissue.

A duplicate or any other document of title purporting to cover goods already represented by an outstanding document of the same issuer does not confer any right in the goods, except as provided in the case of tangible bills of lading in a set of parts, overissue of documents for fungible goods, substitutes for lost, stolen, or destroyed documents, or substitute documents issued pursuant to Section 7-105. The issuer is liable for damages caused by its overissue or failure to identify a duplicate document by a conspicuous notation.

7-403. Obligation of Warehouse or Carrier to Deliver; Excuse.

(a) A bailee shall deliver the goods to a person entitled under a document of title if the person complies with subsections (b) and (c), unless and to the extent that the bailee establishes any of the following:

(1) delivery of the goods to a person whose receipt was rightful as against the claimant;

(2) damage to or delay, loss, or destruction of the goods for which the bailee is not liable;

(3) previous sale or other disposition of the goods in lawful enforcement of a lien or on a warehouse's lawful termination of storage;

(4) the exercise by a seller of its right to stop delivery pursuant to Section 2-705 or by a lessor of its right to stop delivery pursuant to Section 2A-526;

(5) a diversion, reconsignment, or other disposition pursuant to Section 7-303;

(6) release, satisfaction, or any other fact affording a personal defense against the claimant; or

(7) any other lawful excuse.

(b) A person claiming goods covered by a document of title shall satisfy the bailee's lien if the bailee so requests or the bailee is prohibited by law from delivering the goods until the charges are paid.

(c) Unless a person claiming the goods is one against which the document of title does not confer a right under Section 7-503(a):

(1) the person claiming under a document shall surrender possession or control of any outstanding negotiable document covering the goods for cancellation or indication of partial deliveries; and

(2) the bailee shall cancel the document or conspicuously indicate in the document the partial delivery or be liable to any person to which the document is duly negotiated.

7-404. No Liability for Good Faith Delivery Pursuant to Document of Title.

A bailee that in good faith has received goods and delivered or otherwise disposed of the goods according to the terms of a document of title or pursuant to this article is not liable for the goods even if:

(1) the person from which the bailee received the goods did not have authority to procure the document or to dispose of the goods; or

(2) the person to which the bailee delivered the goods did not have authority to receive the goods.

PART 5. WAREHOUSE RECEIPTS AND BILLS OF LADING: **NEGOTIATION AND TRANSFER** [Table of Contents]

7-501. Form of Negotiation and Requirements of Due Negotiation.

(a) The following rules apply to a negotiable tangible document of title:

(1) If the document's original terms run to the order of a named person, the document is negotiated by the named person's indorsement and delivery. After the named person's indorsement in blank or to bearer, any person may negotiate the document by delivery alone.

(2) If the document's original terms run to bearer, it is negotiated by delivery alone.

(3) If the document's original terms run to the order of a named person and it is delivered to the named person, the effect is the same as if the document had been negotiated.

(4) Negotiation of the document after it has been indorsed to a named person requires indorsement by the named person as well as delivery.

(5) A document is duly negotiated if it is negotiated in the manner stated in this subsection to a holder that purchases it in good faith, without notice of any defense against or claim to it on the part of any person, and for value, unless it is established that the negotiation is not in the regular course of business or financing or involves receiving the document in settlement or payment of a monetary obligation.

(b) The following rules apply to a negotiable electronic document of title:

(1) If the document's original terms run to the order of a named person or to bearer, the document is negotiated by delivery of the document to another person. Indorsement by the named person is not required to negotiate the document.

(2) If the document's original terms run to the order of a named person and the named person has control of the document, the effect is the same as if the document had been negotiated.

(3) A document is duly negotiated if it is negotiated in the manner stated in this subsection to a holder that purchases it in good faith, without notice of any defense against or claim to it on the part of any person, and for value, unless it is established that the negotiation is not in the regular course of business or financing or involves taking delivery of the document in settlement or payment of a monetary obligation.

(c) Indorsement of a nonnegotiable document of title neither makes it negotiable nor adds to the transferee's rights.

(d) The naming in a negotiable bill of lading of a person to be notified of the arrival of the goods does not limit the negotiability of the bill or constitute notice to a purchaser of the bill of any interest of that person in the goods.

7-502. Rights Acquired by Due Negotiation.

(a) Subject to Sections 7-205 and 7-503, a holder to which a negotiable document of title has been duly negotiated acquires thereby:

(1) title to the document;

(2) title to the goods;

(3) all rights accruing under the law of agency or estoppel, including rights to goods delivered to the bailee after the document was issued; and

(4) the direct obligation of the issuer to hold or deliver the goods according to the terms of the document free of any defense or claim by the issuer except those arising under the terms of the document or under this article. In the case of a delivery order, the bailee's obligation accrues only upon the bailee's acceptance of the delivery order and the obligation acquired by the holder is that the issuer and any indorser will procure the acceptance of the bailee.

(b) Subject to Section 7-503, title and rights acquired by due negotiation are not defeated by any stoppage of the goods represented by the document of title or by surrender of the goods by the bailee and are not impaired even if:

(1) the due negotiation or any prior due negotiation constituted a breach of duty;

(2) any person has been deprived of possession of a negotiable tangible document or control of a negotiable electronic document by misrepresentation, fraud, accident, mistake, duress, loss, theft, or conversion; or

(3) a previous sale or other transfer of the goods or document has been made to a third person.

7-503. Document of Title to Goods Defeated in Certain Cases.

(a) A document of title confers no right in goods against a person that before issuance of the document had a legal interest or a perfected security interest in the goods and that did not:

(1) deliver or entrust the goods or any document covering the goods to the bailor or the bailor's nominee with actual or apparent authority to ship, store, or sell; with power to obtain delivery under Section 7-403; or with power of disposition under Section 2-403, 2A-304(2), 2A-305(2), or 9-320 or other statute or rule of law; or

(2) acquiesce in the procurement by the bailor or its nominee of any document.

(b) Title to goods based upon an unaccepted delivery order is subject to the rights of any person to which a negotiable warehouse receipt or bill of lading covering the goods has been duly negotiated. That title may be defeated under Section 7-504 to the same extent as the rights of the issuer or a transferee from the issuer.

(c) Title to goods based upon a bill of lading issued to a freight forwarder is subject to the rights of any person to which a bill issued by the freight forwarder is duly negotiated. However, delivery by the carrier in accordance with Part 4 pursuant to its own bill of lading discharges the carrier's obligation to deliver.

7-504. Rights Acquired in the Absence of Due Negotiation; Effect of Diversion; Stoppage of Delivery.

(a) A transferee of a document of title, whether negotiable or nonnegotiable, to which the document has been delivered but not duly negotiated, acquires the title and rights that its transferor had or had actual authority to convey.

(b) In the case of a nonnegotiable document of title, until but not after the bailee receives notice of the transfer, the rights of the transferee may be defeated:

(1) by those creditors of the transferor that could treat the transfer as void under Section 2-402 or 2A-308;

(2) by a buyer from the transferor in ordinary course of business if the bailee has delivered the goods to the buyer or received notification of the buyer's rights;

(3) by a lessee from the transferor in ordinary course of business if the bailee has delivered the goods to the lessee or received notification of the lessee's rights; or

(4) as against the bailee, by good faith dealings of the bailee with the transferor.

(c) A diversion or other change of shipping instructions by the consignor in a nonnegotiable bill of lading which causes the bailee not to deliver the goods to the consignee defeats the consignee's title to the goods if the goods have been delivered to a buyer in ordinary course of business or a lessee in ordinary course of business and in any event defeats the consignee's rights against the bailee.

(d) Delivery of the goods pursuant to a nonnegotiable document of title may be stopped by a seller under Section 2-705 or a lessor under Section 2A-526, subject to the requirements of due notification in those sections. A bailee honoring the seller's or lessor's instructions is entitled to be indemnified by the seller or lessor against any resulting loss or expense.

7-505. Indorser Not a Guarantor for Other Parties.

The indorsement of a tangible document of title issued by a bailee does not make the indorser liable for any default by the bailee or previous indorsers.

7-506. Delivery Without Indorsement: Right to Compel Indorsement.

The transferee of a negotiable tangible document of title has a specifically enforceable right to have its transferor supply any necessary indorsement, but the transfer becomes a negotiation only as of the time the indorsement is supplied.

7-507. Warranties on Negotiation or Transfer of Document of Title.

If a person negotiates or delivers a document of title for value, otherwise than as a mere intermediary under Section 7-508, unless otherwise agreed, the transferor warrants to its immediate purchaser only in addition to any warranty made in selling or leasing the goods that:

(1) the document is genuine;

(2) the transferor does not have knowledge of any fact that would impair the document's validity or worth; and

(3) the negotiation or delivery is rightful and fully effective with respect to the title to the document and the goods it represents.

7-508. Warranties of Collecting Bank as to Documents of Title.

A collecting bank or other intermediary known to be entrusted with documents of title on behalf of another or with collection of a draft or other claim against delivery of documents warrants by the delivery of the documents only its own good faith and authority even if the collecting bank or other intermediary has purchased or made advances against the claim or draft to be collected.

7-509. Adequate Compliance With Commercial Contract.

Whether a document of title is adequate to fulfill the obligations of a contract for sale, a contract for lease, or the conditions of a letter of credit is determined by Article 2, 2A, or 5.

PART 6. WAREHOUSE RECEIPTS AND BILLS OF LADING: MISCELLANEOUS PROVISIONS [Table of Contents]

7-601. Lost, Stolen, or Destroyed Documents of Title.

(a) If a document of title is lost, stolen, or destroyed, a court may order delivery of the goods or issuance of a substitute document and the bailee may without liability to any person comply with the order. If the document was negotiable, a court may not order delivery of the goods or issuance of a substitute document without the claimant's posting security unless it finds that any person that may suffer loss as a result of nonsurrender of possession or control of the document is adequately protected against the loss. If the document was nonnegotiable, the court may require security. The court may also order payment of the bailee's reasonable costs and attorney's fees in any action under this subsection.

(b) A bailee that without court order delivers goods to a person claiming under a missing negotiable document of title is liable to any person injured thereby. If the delivery is not in good faith, the bailee is liable for conversion. Delivery in good faith is not conversion if the claimant posts security with the bailee in an amount at least double the value of the goods at the time of posting to indemnify any person injured by the delivery which files a notice of claim within one year after the delivery.

7-602. Attachment of Goods Covered by a Negotiable Document.

Unless a document of title was originally issued upon delivery of the goods by a person that did not have power to dispose of them, a lien does not attach by virtue of any judicial process to goods in the possession of a bailee for which a negotiable document of title is outstanding unless possession or control of the document is first surrendered to the bailee or the document's negotiation is enjoined. The bailee may not be compelled to deliver the goods pursuant to process until possession or control of the

document is surrendered to the bailee or to the court. A purchaser of the document for value without notice of the process or injunction takes free of the lien imposed by judicial process.

7-603. Conflicting Claims; Interpleader.

If more than one person claims title to or possession of the goods, the bailee is excused from delivery until the bailee has a reasonable time to ascertain the validity of the adverse claims or to commence an action for interpleader. The bailee may assert an interpleader either in defending an action for nondelivery of the goods or by original action.

PART 7. MISCELLANEOUS PROVISIONS [Table of Contents]

7-701. Effective Date.

This [Act] takes effect on _____, 20___.

7-702. Repeals.

[Existing Article 7] and [Section 10-104 of the Uniform Commercial Code] are repealed.

7-703. Applicability.

This [Act] applies to a document of title that is issued or a bailment that arises on or after the effective date of this [Act]. This [Act] does not apply to a document of title that is issued or a bailment that arises before the effective date of this [Act] even if the document of title or bailment would be subject to this [Act] if the document of title had been issued or bailment had arisen after the effective date of this [Act]. This [Act] does not apply to a right of action that has accrued before the effective date of this [Act].

7-704. Savings Clause.

A document of title issued or a bailment that arises before the effective date of this [Act] and the rights, obligations, and interests flowing from that document or bailment are governed by any statute or other rule amended or repealed by this [Act] as if amendment or repeal had not occurred and may be terminated, completed, consummated, or enforced under that statute or other rule.

ARTICLE 8 - INVESTMENT SECURITIES

PART 1. SHORT TITLE AND GENERAL MATTERS

8-101. SHORT TITLE.

This Article may be cited as Uniform Commercial Code--Investment Securities.

8-102. DEFINITIONS.

(a) In this Article:

(1) "**Adverse claim**" means a claim that a claimant has a property interest in a financial asset and that it is a violation of the rights of the claimant for another person to hold, transfer, or deal with the financial asset.

(2) "**Bearer form,**" as applied to a certificated security, means a form in which the security is payable to the bearer of the security certificate according to its terms but not by reason of an indorsement.

(3) "**Broker**" means a person defined as a broker or dealer under the federal securities laws, but without excluding a bank acting in that capacity.

(4) "**Certificated security**" means a security that is represented by a certificate.

(5) "**Clearing corporation**" means:

(i) a person that is registered as a "clearing agency" under the federal securities laws;

(ii) a federal reserve bank; or

(iii) any other person that provides clearance or settlement services with respect to financial assets that would require it to register as a clearing agency under the federal securities laws but for an exclusion or exemption from the registration requirement, if its activities as a clearing corporation, including promulgation of rules, are subject to regulation by a federal or state governmental authority.

(6) "**Communicate**" means to:

(i) send a signed writing; or

(ii) transmit information by any mechanism agreed upon by the persons transmitting and receiving the information.

(7) "**Entitlement holder**" means a person identified in the records of a securities intermediary as the person having a security entitlement against the securities intermediary. If a person acquires a security entitlement by virtue of Section 8-501(b)(2) or (3), that person is the entitlement holder.

(8) "**Entitlement order**" means a notification communicated to a securities intermediary directing transfer or redemption of a financial asset to which the entitlement holder has a security entitlement.

(9) "**Financial asset,**" except as otherwise provided in Section 8-103, means:

(i) a security;

(ii) an obligation of a person or a share, participation, or other interest in a person or in property or an enterprise of a person, which is, or is of a type, dealt in or traded on financial markets, or which is recognized in any area in which it is issued or dealt in as a medium for investment; or

(iii) any property that is held by a securities intermediary for another person in a securities account if the securities intermediary has expressly agreed with the other person that the property is to be treated as a financial asset under this Article.

As context requires, the term means either the interest itself or the means by which a person's claim to it is evidenced, including a certificated or uncertificated security, a security certificate, or a security entitlement.

(10) [reserved]

(11) "**Indorsement**" means a signature that alone or accompanied by other words is made on a security certificate in registered form or on a separate document for the purpose of assigning, transferring, or redeeming the security or granting a power to assign, transfer, or redeem it.

(12) "**Instruction**" means a notification communicated to the issuer of an uncertificated security which directs that the transfer of the security be registered or that the security be redeemed.

(13) "**Registered form,**" as applied to a certificated security, means a form in which:

(i) the security certificate specifies a person entitled to the security; and

(ii) a transfer of the security may be registered upon books maintained for that purpose by or on behalf of the issuer, or the security certificate so states.

(14) "**Securities intermediary**" means:

(i) a clearing corporation; or

(ii) a person, including a bank or broker, that in the ordinary course of its business maintains securities accounts for others and is acting in that capacity.

(15) "**Security,**" except as otherwise provided in Section 8-103, means an obligation of an issuer or a share, participation, or other interest in an issuer or in property or an enterprise of an issuer:

(i) which is represented by a security certificate in bearer or registered form, or the transfer of which may be registered upon books maintained for that purpose by or on behalf of the issuer;

(ii) which is one of a class or series or by its terms is divisible into a class or series of shares, participations, interests, or obligations; and

(iii) which:

(A) is, or is of a type, dealt in or traded on securities exchanges or securities markets; or

(B) is a medium for investment and by its terms expressly provides that it is a security governed by this Article.

(16) "**Security certificate**" means a certificate representing a security.

(17) "**Security entitlement**" means the rights and property interest of an entitlement holder with respect to a financial asset specified in Part 5.

(18) "**Uncertificated security**" means a security that is not represented by a certificate.

(b) Other definitions applying to this Article and the sections in which they appear are:

Appropriate person	Section 8-107
Control	Section 8-106
Delivery	Section 8-301
Investment company security	Section 8-103

Issuer	Section 8-201
Overissue	Section 8-210
Protected purchaser	Section 8-303
Securities account	Section 8-501

(c) In addition, Article 1 contains general definitions and principles of construction and interpretation applicable throughout this Article.

(d) The characterization of a person, business, or transaction for purposes of this Article does not determine the characterization of the person, business, or transaction for purposes of any other law, regulation, or rule.

8-103. RULES FOR DETERMINING WHETHER CERTAIN OBLIGATIONS AND INTERESTS ARE SECURITIES OR FINANCIAL ASSETS.

(a) A share or similar equity interest issued by a corporation, business trust, joint stock company, or similar entity is a security.

(b) An "**investment company security**" is a security. "Investment company security" means a share or similar equity interest issued by an entity that is registered as an investment company under the federal investment company laws, an interest in a unit investment trust that is so registered, or a face-amount certificate issued by a face-amount certificate company that is so registered. Investment company security does not include an insurance policy or endowment policy or annuity contract issued by an insurance company.

(c) An interest in a partnership or limited liability company is not a security unless it is dealt in or traded on securities exchanges or in securities markets, its terms expressly provide that it is a security governed by this Article, or it is an investment company security. However, an interest in a partnership or limited liability company is a financial asset if it is held in a securities account.

(d) A writing that is a security certificate is governed by this Article and not by Article 3, even though it also meets the requirements of that Article. However, a negotiable instrument governed by Article 3 is a financial asset if it is held in a securities account.

(e) An option or similar obligation issued by a clearing corporation to its participants is not a security, but is a financial asset.

(f) A commodity contract, as defined in Section 9-102(a)(15), is not a security or a financial asset.

(g) A document of title is not a financial asset unless Section 8-102(a)(9)(iii) applies.

8-104. ACQUISITION OF SECURITY OR FINANCIAL ASSET OR INTEREST THEREIN.

(a) A person acquires a security or an interest therein, under this Article, if:

(1) the person is a purchaser to whom a security is delivered pursuant to Section 8-301; or

(2) the person acquires a security entitlement to the security pursuant to Section 8-501.

(b) A person acquires a financial asset, other than a security, or an interest therein, under this Article, if the person acquires a security entitlement to the financial asset.

(c) A person who acquires a security entitlement to a security or other financial asset has the rights specified in Part 5, but is a purchaser of any security, security entitlement, or other financial asset held by the securities intermediary only to the extent provided in Section 8-503.

(d) Unless the context shows that a different meaning is intended, a person who is required by other law, regulation, rule, or agreement to transfer, deliver, present, surrender, exchange, or otherwise put in the possession of another person a security or financial asset satisfies that requirement by causing the other person to acquire an interest in the security or financial asset pursuant to subsection (a) or (b).

8-105. NOTICE OF ADVERSE CLAIM.

(a) A person has **notice of an adverse claim** if:

(1) the person knows of the adverse claim;

(2) the person is aware of facts sufficient to indicate that there is a significant probability that the adverse claim exists and deliberately avoids information that would establish the existence of the adverse claim; or

(3) the person has a duty, imposed by statute or regulation, to investigate whether an adverse claim exists, and the investigation so required would establish the existence of the adverse claim.

(b) Having knowledge that a financial asset or interest therein is or has been transferred by a representative imposes no duty of inquiry into the rightfulness of a transaction and is not notice of an adverse claim. However, a person who knows that a representative has transferred a financial asset or interest therein in a transaction that is, or whose proceeds are being used, for the individual benefit of the representative or otherwise in breach of duty has notice of an adverse claim.

(c) An act or event that creates a right to immediate performance of the principal obligation represented by a security certificate or sets a date on or after which the certificate is to be presented or surrendered for redemption or exchange does not itself constitute notice of an adverse claim except in the case of a transfer more than:

(1) one year after a date set for presentment or surrender for redemption or exchange; or

(2) six months after a date set for payment of money against presentation or surrender of the certificate, if money was available for payment on that date.

(d) A purchaser of a certificated security has notice of an adverse claim if the security certificate:

(1) whether in bearer or registered form, has been indorsed "for collection" or "for surrender" or for some other purpose not involving transfer; or

(2) is in bearer form and has on it an unambiguous statement that it is the property of a person other than the transferor, but the mere writing of a name on the certificate is not such a statement.

(e) Filing of a financing statement under Article 9 is not notice of an adverse claim to a financial asset.

8-106. CONTROL.

(a) A purchaser has "**control**" of a certificated security in bearer form if the certificated security is delivered to the purchaser.

(b) A purchaser has "control" of a certificated security in registered form if the certificated security is delivered to the purchaser, and:

(1) the certificate is indorsed to the purchaser or in blank by an effective indorsement; or

(2) the certificate is registered in the name of the purchaser, upon original issue or registration of transfer by the issuer.

(c) A purchaser has "control" of an uncertificated security if:

(1) the uncertificated security is delivered to the purchaser; or

(2) the issuer has agreed that it will comply with instructions originated by the purchaser without further consent by the registered owner.

(d) A purchaser has "control" of a security entitlement if:

(1) the purchaser becomes the entitlement holder; or

(2) the securities intermediary has agreed that it will comply with entitlement orders originated by the purchaser without further consent by the entitlement holder, or

(3) another person has control of the security entitlement on behalf of the purchaser or, having previously acquired control of the security entitlement, acknowledges that it has control on behalf of the purchaser.

(e) If an interest in a security entitlement is granted by the entitlement holder to the entitlement holder's own securities intermediary, the securities intermediary has control.

(f) A purchaser who has satisfied the requirements of subsection (c) or (d) has control even if the registered owner in the case of subsection (c) or the entitlement holder in the case of subsection (d) retains the right to make substitutions for the uncertificated security or security entitlement, to originate instructions or entitlement orders to the issuer or securities intermediary, or otherwise to deal with the uncertificated security or security entitlement.

(g) An issuer or a securities intermediary may not enter into an agreement of the kind described in subsection (c)(2) or (d)(2) without the consent of the registered owner or entitlement holder, but an issuer or a securities intermediary is not required to enter into such an agreement even though the registered owner or entitlement holder so directs. An issuer or securities intermediary that has entered into such an agreement is not required to confirm the existence of the agreement to another party unless requested to do so by the registered owner or entitlement holder.

8-107. WHETHER INDORSEMENT, INSTRUCTION, OR ENTITLEMENT ORDER IS EFFECTIVE.

(a) "**Appropriate person**" means:

(1) with respect to an indorsement, the person specified by a security certificate or by an effective special indorsement to be entitled to the security;

(2) with respect to an instruction, the registered owner of an uncertificated security;

(3) with respect to an entitlement order, the entitlement holder;

(4) if the person designated in paragraph (1), (2), or (3) is deceased, the designated person's successor taking under other law or the designated person's personal representative acting for the estate of the decedent; or

(5) if the person designated in paragraph (1), (2), or (3) lacks capacity, the designated person's guardian, conservator, or other similar representative who has power under other law to transfer the security or financial asset.

(b) An indorsement, instruction, or entitlement order is **effective** if:

(1) it is made by the appropriate person;

(2) it is made by a person who has power under the law of agency to transfer the security or financial asset on behalf of the appropriate person, including, in the case of an instruction or entitlement order, a person who has control under Section 8-106(c)(2) or (d)(2); or

(3) the appropriate person has ratified it or is otherwise precluded from asserting its ineffectiveness.

(c) An indorsement, instruction, or entitlement order made by a representative is effective even if:

(1) the representative has failed to comply with a controlling instrument or with the law of the State having jurisdiction of the representative relationship, including any law requiring the representative to obtain court approval of the transaction; or

(2) the representative's action in making the indorsement, instruction, or entitlement order or using the proceeds of the transaction is otherwise a breach of duty.

(d) If a security is registered in the name of or specially indorsed to a person described as a representative, or if a securities account is maintained in the name of a person described as a representative, an indorsement, instruction, or entitlement order made by the person is effective even though the person is no longer serving in the described capacity.

(e) Effectiveness of an indorsement, instruction, or entitlement order is determined as of the date the indorsement, instruction, or entitlement order is made, and an indorsement, instruction, or entitlement order does not become ineffective by reason of any later change of circumstances.

8-108. WARRANTIES IN DIRECT HOLDING.

(a) A person who transfers a certificated security to a purchaser for value warrants to the purchaser, and an indorser, if the transfer is by indorsement, warrants to any subsequent purchaser, that:

(1) the certificate is genuine and has not been materially altered;

(2) the transferor or indorser does not know of any fact that might impair the validity of the security;

(3) there is no adverse claim to the security;

(4) the transfer does not violate any restriction on transfer;

(5) if the transfer is by indorsement, the indorsement is made by an appropriate person, or if the indorsement is by an agent, the agent has actual authority to act on behalf of the appropriate person; and

(6) the transfer is otherwise effective and rightful.

(b) A person who originates an instruction for registration of transfer of an uncertificated security to a purchaser for value warrants to the purchaser that:

(1) the instruction is made by an appropriate person, or if the instruction is by an agent, the agent has actual authority to act on behalf of the appropriate person;

(2) the security is valid;

(3) there is no adverse claim to the security; and

(4) at the time the instruction is presented to the issuer:

(i) the purchaser will be entitled to the registration of transfer;

(ii) the transfer will be registered by the issuer free from all liens, security interests, restrictions, and claims other than those specified in the instruction;

(iii) the transfer will not violate any restriction on transfer; and

(iv) the requested transfer will otherwise be effective and rightful.

(c) A person who transfers an uncertificated security to a purchaser for value and does not originate an instruction in connection with the transfer warrants that:

(1) the uncertificated security is valid;

(2) there is no adverse claim to the security;

(3) the transfer does not violate any restriction on transfer; and

(4) the transfer is otherwise effective and rightful.

(d) A person who indorses a security certificate warrants to the issuer that:

(1) there is no adverse claim to the security; and

(2) the indorsement is effective.

(e) A person who originates an instruction for registration of transfer of an uncertificated security warrants to the issuer that:

(1) the instruction is effective; and

(2) at the time the instruction is presented to the issuer the purchaser will be entitled to the registration of transfer.

(f) A person who presents a certificated security for registration of transfer or for payment or exchange warrants to the issuer that the person is entitled to the registration, payment, or exchange, but a purchaser for value and without notice of adverse claims to whom transfer is registered warrants only that the person has no knowledge of any unauthorized signature in a necessary indorsement.

(g) If a person acts as agent of another in delivering a certificated security to a purchaser, the identity of the principal was known to the person to whom the certificate was delivered, and the certificate delivered by the agent was received by the agent from the principal or received by the agent from another person at the direction of the principal, the person delivering the security certificate warrants only that the delivering person has authority to act for the principal and does not know of any adverse claim to the certificated security.

(h) A secured party who redelivers a security certificate received, or after payment and on order of the debtor delivers the security certificate to another person, makes only the warranties of an agent under subsection (g).

(i) Except as otherwise provided in subsection (g), a broker acting for a customer makes to the issuer and a purchaser the warranties provided in subsections (a) through (f). A broker that delivers a security certificate to its customer, or causes its customer to be registered as the owner of an uncertificated security, makes to the customer the warranties provided in subsection (a) or (b), and has the rights and privileges of a purchaser under this section. The warranties of and in favor of the broker acting as an agent are in addition to applicable warranties given by and in favor of the customer.

8-109. WARRANTIES IN INDIRECT HOLDING.

(a) A person who originates an entitlement order to a securities intermediary warrants to the securities intermediary that:

(1) the entitlement order is made by an appropriate person, or if the entitlement order is by an agent, the agent has actual authority to act on behalf of the appropriate person; and

(2) there is no adverse claim to the security entitlement.

(b) A person who delivers a security certificate to a securities intermediary for credit to a securities account or originates an instruction with respect to an uncertificated security directing that the uncertificated security be credited to a securities account makes to the securities intermediary the warranties specified in Section 8-108(a) or (b).

(c) If a securities intermediary delivers a security certificate to its entitlement holder or causes its entitlement holder to be registered as the owner of an uncertificated security, the securities intermediary makes to the entitlement holder the warranties specified in Section 8-108(a) or (b).

8-110. APPLICABILITY; CHOICE OF LAW.

(a) The local law of the issuer's jurisdiction, as specified in subsection (d), governs:

(1) the validity of a security;

(2) the rights and duties of the issuer with respect to registration of transfer;

(3) the effectiveness of registration of transfer by the issuer;

(4) whether the issuer owes any duties to an adverse claimant to a security; and

(5) whether an adverse claim can be asserted against a person to whom transfer of a certificated or uncertificated security is registered or a person who obtains control of an uncertificated security.

(b) The local law of the securities intermediary's jurisdiction, as specified in subsection (e), governs:

(1) acquisition of a security entitlement from the securities intermediary;

(2) the rights and duties of the securities intermediary and entitlement holder arising out of a security entitlement;

(3) whether the securities intermediary owes any duties to an adverse claimant to a security entitlement; and

(4) whether an adverse claim can be asserted against a person who acquires a security entitlement from the securities intermediary or a person who purchases a security entitlement or interest therein from an entitlement holder.

(c) The local law of the jurisdiction in which a security certificate is located at the time of delivery governs whether an adverse claim can be asserted against a person to whom the security certificate is delivered.

(d) "Issuer's jurisdiction" means the jurisdiction under which the issuer of the security is organized or, if permitted by the law of that jurisdiction, the law of another jurisdiction specified by the issuer. An issuer organized under the law of this State may specify the law of another jurisdiction as the law governing the matters specified in subsection (a)(2) through (5).

(e) The following rules determine a "securities intermediary's jurisdiction" for purposes of this section:

(1) If an agreement between the securities intermediary and its entitlement holder governing the securities account expressly provides that a particular jurisdiction is the securities intermediary's jurisdiction for purposes of this part, this article, or this act, that jurisdiction is the securities intermediary's jurisdiction.

(2) If paragraph (1) does not apply and an agreement between the securities intermediary and its entitlement holder expressly provides that the agreement is governed by the law of a particular jurisdiction, that jurisdiction is the securities intermediary's jurisdiction.

(3) If neither paragraph (i) nor paragraph (ii) applies and an agreement between the securities intermediary and its entitlement holder governing the securities account expressly provides that the securities account is maintained at an office in a particular jurisdiction, that jurisdiction is the securities intermediary's jurisdiction.

(4) If none of the preceding paragraphs applies, the securities intermediary's jurisdiction is the jurisdiction in which the office identified in an account statement as the office serving the entitlement holder's account is located.

(5) If none of the preceding paragraphs applies, the securities intermediary's jurisdiction is the jurisdiction in which the chief executive office of the securities intermediary is located.

(f) A securities intermediary's jurisdiction is not determined by the physical location of certificates representing financial assets, or by the jurisdiction in which is organized the issuer of the financial asset with respect to which an entitlement holder has a security entitlement, or by the location of facilities for data processing or other record keeping concerning the account.

8-111. CLEARING CORPORATION RULES.

A rule adopted by a clearing corporation governing rights and obligations among the clearing corporation and its participants in the clearing corporation is effective even if the rule conflicts with this [Act] and affects another party who does not consent to the rule.

8-112. CREDITOR'S LEGAL PROCESS.

(a) The interest of a debtor in a certificated security may be reached by a creditor only by actual seizure of the security certificate by the officer making the attachment or levy, except as otherwise

provided in subsection (d). However, a certificated security for which the certificate has been surrendered to the issuer may be reached by a creditor by legal process upon the issuer.

(b) The interest of a debtor in an uncertificated security may be reached by a creditor only by legal process upon the issuer at its chief executive office in the United States, except as otherwise provided in subsection (d).

(c) The interest of a debtor in a security entitlement may be reached by a creditor only by legal process upon the securities intermediary with whom the debtor's securities account is maintained, except as otherwise provided in subsection (d).

(d) The interest of a debtor in a certificated security for which the certificate is in the possession of a secured party, or in an uncertificated security registered in the name of a secured party, or a security entitlement maintained in the name of a secured party, may be reached by a creditor by legal process upon the secured party.

(e) A creditor whose debtor is the owner of a certificated security, uncertificated security, or security entitlement is entitled to aid from a court of competent jurisdiction, by injunction or otherwise, in reaching the certificated security, uncertificated security, or security entitlement or in satisfying the claim by means allowed at law or in equity in regard to property that cannot readily be reached by other legal process.

8-113. STATUTE OF FRAUDS INAPPLICABLE.

A contract or modification of a contract for the sale or purchase of a security is enforceable whether or not there is a writing signed or record authenticated by a party against whom enforcement is sought, even if the contract or modification is not capable of performance within one year of its making.

8-114. EVIDENTIARY RULES CONCERNING CERTIFICATED SECURITIES.

The following rules apply in an action on a certificated security against the issuer:

(1) Unless specifically denied in the pleadings, each signature on a security certificate or in a necessary indorsement is admitted.

(2) If the effectiveness of a signature is put in issue, the burden of establishing effectiveness is on the party claiming under the signature, but the signature is presumed to be genuine or authorized.

(3) If signatures on a security certificate are admitted or established, production of the certificate entitles a holder to recover on it unless the defendant establishes a defense or a defect going to the validity of the security.

(4) If it is shown that a defense or defect exists, the plaintiff has the burden of establishing that the plaintiff or some person under whom the plaintiff claims is a person against whom the defense or defect cannot be asserted.

8-115. SECURITIES INTERMEDIARY AND OTHERS NOT LIABLE TO ADVERSE CLAIMANT.

A securities intermediary that has transferred a financial asset pursuant to an effective entitlement order, or a broker or other agent or bailee that has dealt with a financial asset at the direction of its customer or principal, is not liable to a person having an adverse claim to the financial asset, unless the securities intermediary, or broker or other agent or bailee:

(1) took the action after it had been served with an injunction, restraining order, or other legal process enjoining it from doing so, issued by a court of competent jurisdiction, and had a reasonable opportunity to act on the injunction, restraining order, or other legal process; or

(2) acted in collusion with the wrongdoer in violating the rights of the adverse claimant; or

(3) in the case of a security certificate that has been stolen, acted with notice of the adverse claim.

8-116. SECURITIES INTERMEDIARY AS PURCHASER FOR VALUE.

A securities intermediary that receives a financial asset and establishes a security entitlement to the financial asset in favor of an entitlement holder is a purchaser for value of the financial asset. A securities intermediary that acquires a security entitlement to a financial asset from another securities intermediary acquires the security entitlement for value if the securities intermediary acquiring the security entitlement establishes a security entitlement to the financial asset in favor of an entitlement holder.

PART 2. ISSUE AND ISSUER [Table of Contents]

8-201. ISSUER.

(a) With respect to an obligation on or a defense to a security, an "**issuer**" includes a person that:

(1) places or authorizes the placing of its name on a security certificate, other than as authenticating trustee, registrar, transfer agent, or the like, to evidence a share, participation, or other interest in its property or in an enterprise, or to evidence its duty to perform an obligation represented by the certificate;

(2) creates a share, participation, or other interest in its property or in an enterprise, or undertakes an obligation, that is an uncertificated security;

(3) directly or indirectly creates a fractional interest in its rights or property, if the fractional interest is represented by a security certificate; or

(4) becomes responsible for, or in place of, another person described as an issuer in this section.

(b) With respect to an obligation on or defense to a security, a guarantor is an issuer to the extent of its guaranty, whether or not its obligation is noted on a security certificate.

(c) With respect to a registration of a transfer, issuer means a person on whose behalf transfer books are maintained.

8-202. ISSUER'S RESPONSIBILITY AND DEFENSES; NOTICE OF DEFECT OR DEFENSE.

(a) Even against a purchaser for value and without notice, the terms of a certificated security include terms stated on the certificate and terms made part of the security by reference on the certificate to another instrument, indenture, or document or to a constitution, statute, ordinance, rule, regulation, order, or the like, to the extent the terms referred to do not conflict with terms stated on the certificate. A reference under this subsection does not of itself charge a purchaser for value with notice of a defect going to the validity of the security, even if the certificate expressly states that a person accepting it admits notice. The terms of an uncertificated security include those stated in any instrument, indenture, or document or in a constitution, statute, ordinance, rule, regulation, order, or the like, pursuant to which the security is issued.

(b) The following rules apply if an issuer asserts that a security is not valid:

(1) A security other than one issued by a government or governmental subdivision, agency, or instrumentality, even though issued with a defect going to its validity, is valid in the hands of a purchaser for value and without notice of the particular defect unless the defect involves a violation of a constitutional provision. In that case, the security is valid in the hands of a purchaser for value and without notice of the defect, other than one who takes by original issue.

(2) Paragraph (1) applies to an issuer that is a government or governmental subdivision, agency, or instrumentality only if there has been substantial compliance with the legal requirements governing the issue or the issuer has received a substantial consideration for the issue as a whole or for the particular security and a stated purpose of the issue is one for which the issuer has power to borrow money or issue the security.

(c) Except as otherwise provided in Section 8-205, lack of genuineness of a certificated security is a complete defense, even against a purchaser for value and without notice.

(d) All other defenses of the issuer of a security, including nondelivery and conditional delivery of a certificated security, are ineffective against a purchaser for value who has taken the certificated security without notice of the particular defense.

(e) This section does not affect the right of a party to cancel a contract for a security "when, as and if issued" or "when distributed" in the event of a material change in the character of the security that is the subject of the contract or in the plan or arrangement pursuant to which the security is to be issued or distributed.

(f) If a security is held by a securities intermediary against whom an entitlement holder has a security entitlement with respect to the security, the issuer may not assert any defense that the issuer could not assert if the entitlement holder held the security directly.

8-203. STALENESS AS NOTICE OF DEFECT OR DEFENSE.

After an act or event, other than a call that has been revoked, creating a right to immediate performance of the principal obligation represented by a certificated security or setting a date on or after which the security is to be presented or surrendered for redemption or exchange, a purchaser is charged with notice of any defect in its issue or defense of the issuer, if the act or event:

(1) requires the payment of money, the delivery of a certificated security, the registration of transfer of an uncertificated security, or any of them on presentation or surrender of the security certificate, the money or security is available on the date set for payment or exchange, and the purchaser takes the security more than one year after that date; or

(2) is not covered by paragraph (1) and the purchaser takes the security more than two years after the date set for surrender or presentation or the date on which performance became due.

8-204. EFFECT OF ISSUER'S RESTRICTION ON TRANSFER.

A restriction on transfer of a security imposed by the issuer, even if otherwise lawful, is ineffective against a person without knowledge of the restriction unless:

(1) the security is certificated and the restriction is noted conspicuously on the security certificate; or

(2) the security is uncertificated and the registered owner has been notified of the restriction.

8-205. EFFECT OF UNAUTHORIZED SIGNATURE ON SECURITY CERTIFICATE.

An unauthorized signature placed on a security certificate before or in the course of issue is ineffective, but the signature is effective in favor of a purchaser for value of the certificated security if the purchaser is without notice of the lack of authority and the signing has been done by:

(1) an authenticating trustee, registrar, transfer agent, or other person entrusted by the issuer with the signing of the security certificate or of similar security certificates, or the immediate preparation for signing of any of them; or

(2) an employee of the issuer, or of any of the persons listed in paragraph (1), entrusted with responsible handling of the security certificate.

8-206. COMPLETION OR ALTERATION OF SECURITY CERTIFICATE.

(a) If a security certificate contains the signatures necessary to its issue or transfer but is incomplete in any other respect:

(1) any person may complete it by filling in the blanks as authorized; and

(2) even if the blanks are incorrectly filled in, the security certificate as completed is enforceable by a purchaser who took it for value and without notice of the incorrectness.

(b) A complete security certificate that has been improperly altered, even if fraudulently, remains enforceable, but only according to its original terms.

8-207. RIGHTS AND DUTIES OF ISSUER WITH RESPECT TO REGISTERED OWNERS.

(a) Before due presentment for registration of transfer of a certificated security in registered form or of an instruction requesting registration of transfer of an uncertificated security, the issuer or indenture trustee may treat the registered owner as the person exclusively entitled to vote, receive notifications, and otherwise exercise all the rights and powers of an owner.

(b) This Article does not affect the liability of the registered owner of a security for a call, assessment, or the like.

8-208. EFFECT OF SIGNATURE OF AUTHENTICATING TRUSTEE, REGISTRAR, OR TRANSFER AGENT.

(a) A person signing a security certificate as authenticating trustee, registrar, transfer agent, or the like, warrants to a purchaser for value of the certificated security, if the purchaser is without notice of a particular defect, that:

(1) the certificate is genuine;

(2) the person's own participation in the issue of the security is within the person's capacity and within the scope of the authority received by the person from the issuer; and

(3) the person has reasonable grounds to believe that the certificated security is in the form and within the amount the issuer is authorized to issue.

(b) Unless otherwise agreed, a person signing under subsection (a) does not assume responsibility for the validity of the security in other respects.

8-209. ISSUER'S LIEN.

A lien in favor of an issuer upon a certificated security is valid against a purchaser only if the right of the issuer to the lien is noted conspicuously on the security certificate.

8-210. OVERISSUE.

(a) In this section, "**overissue**" means the issue of securities in excess of the amount the issuer has corporate power to issue, but an overissue does not occur if appropriate action has cured the overissue.

(b) Except as otherwise provided in subsections (c) and (d), the provisions of this Article which validate a security or compel its issue or reissue do not apply to the extent that validation, issue, or reissue would result in overissue.

(c) If an identical security not constituting an overissue is reasonably available for purchase, a person entitled to issue or validation may compel the issuer to purchase the security and deliver it if certificated or register its transfer if uncertificated, against surrender of any security certificate the person holds.

(d) If a security is not reasonably available for purchase, a person entitled to issue or validation may recover from the issuer the price the person or the last purchaser for value paid for it with interest from the date of the person's demand.

PART 3. TRANSFER OF CERTIFICATED AND UNCERTIFICATED SECURITIES [Table of Contents]

8-301. DELIVERY.

(a) **Delivery** of a certificated security to a purchaser occurs when:

(1) the purchaser acquires possession of the security certificate;

(2) another person, other than a securities intermediary, either acquires possession of the security certificate on behalf of the purchaser or, having previously acquired possession of the certificate, acknowledges that it holds for the purchaser; or

(3) a securities intermediary acting on behalf of the purchaser acquires possession of the security certificate, only if the certificate is in registered form and is (i) registered in the name of the purchaser, (ii) payable to the order of the purchaser, or (iii) specially indorsed to the purchaser by an effective indorsement and has not been indorsed to the securities intermediary or in blank.

(b) Delivery of an uncertificated security to a purchaser occurs when:

(1) the issuer registers the purchaser as the registered owner, upon original issue or registration of transfer; or

(2) another person, other than a securities intermediary, either becomes the registered owner of the uncertificated security on behalf of the purchaser or, having previously become the registered owner, acknowledges that it holds for the purchaser.

8-302. RIGHTS OF PURCHASER.

(a) Except as otherwise provided in subsections (b) and (c), a purchaser of a certificated or uncertificated security acquires all rights in the security that the transferor had or had power to transfer.

(b) A purchaser of a limited interest acquires rights only to the extent of the interest purchased.

(c) A purchaser of a certificated security who as a previous holder had notice of an adverse claim does not improve its position by taking from a protected purchaser.

8-303. PROTECTED PURCHASER.

(a) "**Protected purchaser**" means a purchaser of a certificated or uncertificated security, or of an interest therein, who:

(1) gives value;

(2) does not have notice of any adverse claim to the security; and

(3) obtains control of the certificated or uncertificated security.

(b) In addition to acquiring the rights of a purchaser, a protected purchaser also acquires its interest in the security free of any adverse claim.

8-304. INDORSEMENT.

(a) An indorsement may be in blank or special. An indorsement in blank includes an indorsement to bearer. A **special indorsement** specifies to whom a security is to be transferred or who has power to transfer it. A holder may convert a blank indorsement to a special indorsement.

(b) An indorsement purporting to be only of part of a security certificate representing units intended by the issuer to be separately transferable is effective to the extent of the indorsement.

(c) An indorsement, whether special or in blank, does not constitute a transfer until delivery of the certificate on which it appears or, if the indorsement is on a separate document, until delivery of both the document and the certificate.

(d) If a security certificate in registered form has been delivered to a purchaser without a necessary indorsement, the purchaser may become a protected purchaser only when the indorsement is supplied. However, against a transferor, a transfer is complete upon delivery and the purchaser has a specifically enforceable right to have any necessary indorsement supplied.

(e) An indorsement of a security certificate in bearer form may give notice of an adverse claim to the certificate, but it does not otherwise affect a right to registration that the holder possesses.

(f) Unless otherwise agreed, a person making an indorsement assumes only the obligations provided in Section 8-108 and not an obligation that the security will be honored by the issuer.

8-305. INSTRUCTION.

(a) If an instruction has been originated by an appropriate person but is incomplete in any other respect, any person may complete it as authorized and the issuer may rely on it as completed, even though it has been completed incorrectly.

(b) Unless otherwise agreed, a person initiating an instruction assumes only the obligations imposed by Section 8-108 and not an obligation that the security will be honored by the issuer.

8-306. EFFECT OF GUARANTEEING SIGNATURE, INDORSEMENT, OR INSTRUCTION.

(a) A person who guarantees a signature of an indorser of a security certificate warrants that at the time of signing:

(1) the signature was genuine;

(2) the signer was an appropriate person to indorse, or if the signature is by an agent, the agent had actual authority to act on behalf of the appropriate person; and

(3) the signer had legal capacity to sign.

(b) A person who guarantees a signature of the originator of an instruction warrants that at the time of signing:

(1) the signature was genuine;

(2) the signer was an appropriate person to originate the instruction, or if the signature is by an agent, the agent had actual authority to act on behalf of the appropriate person, if the person specified in the instruction as the registered owner was, in fact, the registered owner, as to which fact the signature guarantor does not make a warranty; and

(3) the signer had legal capacity to sign.

(c) A person who specially guarantees the signature of an originator of an instruction makes the warranties of a signature guarantor under subsection (b) and also warrants that at the time the instruction is presented to the issuer:

(1) the person specified in the instruction as the registered owner of the uncertificated security will be the registered owner; and

(2) the transfer of the uncertificated security requested in the instruction will be registered by the issuer free from all liens, security interests, restrictions, and claims other than those specified in the instruction.

(d) A guarantor under subsections (a) and (b) or a special guarantor under subsection (c) does not otherwise warrant the rightfulness of the transfer.

(e) A person who guarantees an indorsement of a security certificate makes the warranties of a signature guarantor under subsection (a) and also warrants the rightfulness of the transfer in all respects.

(f) A person who guarantees an instruction requesting the transfer of an uncertificated security makes the warranties of a special signature guarantor under subsection (c) and also warrants the rightfulness of the transfer in all respects.

(g) An issuer may not require a special guaranty of signature, a guaranty of indorsement, or a guaranty of instruction as a condition to registration of transfer.

(h) The warranties under this section are made to a person taking or dealing with the security in reliance on the guaranty, and the guarantor is liable to the person for loss resulting from their breach. An indorser or originator of an instruction whose signature, indorsement, or instruction has been guaranteed is liable to a guarantor for any loss suffered by the guarantor as a result of breach of the warranties of the guarantor.

8-307. PURCHASER'S RIGHT TO REQUISITES FOR REGISTRATION OF TRANSFER.

Unless otherwise agreed, the transferor of a security on due demand shall supply the purchaser with proof of authority to transfer or with any other requisite necessary to obtain registration of the transfer of the security, but if the transfer is not for value, a transferor need not comply unless the purchaser pays the necessary expenses. If the transferor fails within a reasonable time to comply with the demand, the purchaser may reject or rescind the transfer.

PART 4. REGISTRATION [Table of Contents]

8-401. DUTY OF ISSUER TO REGISTER TRANSFER.

(a) If a certificated security in registered form is presented to an issuer with a request to register transfer or an instruction is presented to an issuer with a request to register transfer of an uncertificated security, the issuer shall register the transfer as requested if:

(1) under the terms of the security the person seeking registration of transfer is eligible to have the security registered in its name;

(2) the indorsement or instruction is made by the appropriate person or by an agent who has actual authority to act on behalf of the appropriate person;

(3) reasonable assurance is given that the indorsement or instruction is genuine and authorized (Section 8-402);

(4) any applicable law relating to the collection of taxes has been complied with;

(5) the transfer does not violate any restriction on transfer imposed by the issuer in accordance with Section 8-204;

(6) a demand that the issuer not register transfer has not become effective under Section 8-403, or the issuer has complied with Section 8-403(b) but no legal process or indemnity bond is obtained as provided in Section 8-403(d); and

(7) the transfer is in fact rightful or is to a protected purchaser.

(b) If an issuer is under a duty to register a transfer of a security, the issuer is liable to a person presenting a certificated security or an instruction for registration or to the person's principal for loss resulting from unreasonable delay in registration or failure or refusal to register the transfer.

8-402. ASSURANCE THAT INDORSEMENT OR INSTRUCTION IS EFFECTIVE.

(a) An issuer may require the following assurance that each necessary indorsement or each instruction is genuine and authorized:

(1) in all cases, a guaranty of the signature of the person making an indorsement or originating an instruction including, in the case of an instruction, reasonable assurance of identity;

(2) if the indorsement is made or the instruction is originated by an agent, appropriate assurance of actual authority to sign;

(3) if the indorsement is made or the instruction is originated by a fiduciary pursuant to Section 8-107(a)(4) or (a)(5), appropriate evidence of appointment or incumbency;

(4) if there is more than one fiduciary, reasonable assurance that all who are required to sign have done so; and

(5) if the indorsement is made or the instruction is originated by a person not covered by another provision of this subsection, assurance appropriate to the case corresponding as nearly as may be to the provisions of this subsection.

(b) An issuer may elect to require reasonable assurance beyond that specified in this section.

(c) In this section:

(1) "Guaranty of the signature" means a guaranty signed by or on behalf of a person reasonably believed by the issuer to be responsible. An issuer may adopt standards with respect to responsibility if they are not manifestly unreasonable.

(2) "Appropriate evidence of appointment or incumbency" means:

(i) in the case of a fiduciary appointed or qualified by a court, a certificate issued by or under the direction or supervision of the court or an officer thereof and dated within 60 days before the date of presentation for transfer; or

(ii) in any other case, a copy of a document showing the appointment or a certificate issued by or on behalf of a person reasonably believed by an issuer to be responsible or, in the

absence of that document or certificate, other evidence the issuer reasonably considers appropriate.

8-403. DEMAND THAT ISSUER NOT REGISTER TRANSFER.

(a) A person who is an appropriate person to make an indorsement or originate an instruction may demand that the issuer not register transfer of a security by communicating to the issuer a notification that identifies the registered owner and the issue of which the security is a part and provides an address for communications directed to the person making the demand. The demand is effective only if it is received by the issuer at a time and in a manner affording the issuer reasonable opportunity to act on it.

(b) If a certificated security in registered form is presented to an issuer with a request to register transfer or an instruction is presented to an issuer with a request to register transfer of an uncertificated security after a demand that the issuer not register transfer has become effective, the issuer shall promptly communicate to (i) the person who initiated the demand at the address provided in the demand and (ii) the person who presented the security for registration of transfer or initiated the instruction requesting registration of transfer a notification stating that:

(1) the certificated security has been presented for registration of transfer or the instruction for registration of transfer of the uncertificated security has been received;

(2) a demand that the issuer not register transfer had previously been received; and

(3) the issuer will withhold registration of transfer for a period of time stated in the notification in order to provide the person who initiated the demand an opportunity to obtain legal process or an indemnity bond.

(c) The period described in subsection (b)(3) may not exceed 30 days after the date of communication of the notification. A shorter period may be specified by the issuer if it is not manifestly unreasonable.

(d) An issuer is not liable to a person who initiated a demand that the issuer not register transfer for any loss the person suffers as a result of registration of a transfer pursuant to an effective indorsement or instruction if the person who initiated the demand does not, within the time stated in the issuer's communication, either:

(1) obtain an appropriate restraining order, injunction, or other process from a court of competent jurisdiction enjoining the issuer from registering the transfer; or

(2) file with the issuer an indemnity bond, sufficient in the issuer's judgment to protect the issuer and any transfer agent, registrar, or other agent of the issuer involved from any loss it or they may suffer by refusing to register the transfer.

(e) This section does not relieve an issuer from liability for registering transfer pursuant to an indorsement or instruction that was not effective.

8-404. WRONGFUL REGISTRATION.

(a) Except as otherwise provided in Section 8-406, an issuer is liable for wrongful registration of transfer if the issuer has registered a transfer of a security to a person not entitled to it, and the transfer was registered:

(1) pursuant to an ineffective indorsement or instruction;

(2) after a demand that the issuer not register transfer became effective under Section 8-403(a) and the issuer did not comply with Section 8-403(b);

(3) after the issuer had been served with an injunction, restraining order, or other legal process enjoining it from registering the transfer, issued by a court of competent jurisdiction, and the issuer had a reasonable opportunity to act on the injunction, restraining order, or other legal process; or

(4) by an issuer acting in collusion with the wrongdoer.

(b) An issuer that is liable for wrongful registration of transfer under subsection (a) on demand shall provide the person entitled to the security with a like certificated or uncertificated security, and any payments or distributions that the person did not receive as a result of the wrongful registration. If an overissue would result, the issuer's liability to provide the person with a like security is governed by Section 8-210.

(c) Except as otherwise provided in subsection (a) or in a law relating to the collection of taxes, an issuer is not liable to an owner or other person suffering loss as a result of the registration of a transfer of a security if registration was made pursuant to an effective indorsement or instruction.

8-405. REPLACEMENT OF LOST, DESTROYED, OR WRONGFULLY TAKEN SECURITY CERTIFICATE.

(a) If an owner of a certificated security, whether in registered or bearer form, claims that the certificate has been lost, destroyed, or wrongfully taken, the issuer shall issue a new certificate if the owner:

(1) so requests before the issuer has notice that the certificate has been acquired by a protected purchaser;

(2) files with the issuer a sufficient indemnity bond; and

(3) satisfies other reasonable requirements imposed by the issuer.

(b) If, after the issue of a new security certificate, a protected purchaser of the original certificate presents it for registration of transfer, the issuer shall register the transfer unless an overissue would result. In that case, the issuer's liability is governed by Section 8-210. In addition to any rights on the indemnity bond, an issuer may recover the new certificate from a person to whom it was issued or any person taking under that person, except a protected purchaser.

8-406. OBLIGATION TO NOTIFY ISSUER OF LOST, DESTROYED, OR WRONGFULLY TAKEN SECURITY CERTIFICATE.

If a security certificate has been lost, apparently destroyed, or wrongfully taken, and the owner fails to notify the issuer of that fact within a reasonable time after the owner has notice of it and the issuer registers a transfer of the security before receiving notification, the owner may not assert against the issuer a claim for registering the transfer under Section 8-404 or a claim to a new security certificate under Section 8-405.

8-407. AUTHENTICATING TRUSTEE, TRANSFER AGENT, AND REGISTRAR.

A person acting as authenticating trustee, transfer agent, registrar, or other agent for an issuer in the registration of a transfer of its securities, in the issue of new security certificates or uncertificated securities, or in the cancellation of surrendered security certificates has the same obligation to the holder or owner of a certificated or uncertificated security with regard to the particular functions performed as the issuer has in regard to those functions.

PART 5. SECURITY ENTITLEMENTS [Table of Contents]

8-501. SECURITIES ACCOUNT; ACQUISITION OF SECURITY ENTITLEMENT FROM SECURITIES INTERMEDIARY.

(a) "**Securities account**" means an account to which a financial asset is or may be credited in accordance with an agreement under which the person maintaining the account undertakes to treat the person for whom the account is maintained as entitled to exercise the rights that comprise the financial asset.

(b) Except as otherwise provided in subsections (d) and (e), a person acquires a security entitlement if a securities intermediary:

(1) indicates by book entry that a financial asset has been credited to the person's securities account;

(2) receives a financial asset from the person or acquires a financial asset for the person and, in either case, accepts it for credit to the person's securities account; or

(3) becomes obligated under other law, regulation, or rule to credit a financial asset to the person's securities account.

(c) If a condition of subsection (b) has been met, a person has a security entitlement even though the securities intermediary does not itself hold the financial asset.

(d) If a securities intermediary holds a financial asset for another person, and the financial asset is registered in the name of, payable to the order of, or specially indorsed to the other person, and has not been indorsed to the securities intermediary or in blank, the other person is treated as holding the financial asset directly rather than as having a security entitlement with respect to the financial asset.

(e) Issuance of a security is not establishment of a security entitlement.

8-502. ASSERTION OF ADVERSE CLAIM AGAINST ENTITLEMENT HOLDER.

An action based on an adverse claim to a financial asset, whether framed in conversion, replevin, constructive trust, equitable lien, or other theory, may not be asserted against a person who acquires a security entitlement under Section 8-501 for value and without notice of the adverse claim.

8-503. PROPERTY INTEREST OF ENTITLEMENT HOLDER IN FINANCIAL ASSET HELD BY SECURITIES INTERMEDIARY.

(a) To the extent necessary for a securities intermediary to satisfy all security entitlements with respect to a particular financial asset, all interests in that financial asset held by the securities intermediary are held by the securities intermediary for the entitlement holders, are not property of the securities intermediary, and are not subject to claims of creditors of the securities intermediary, except as otherwise provided in Section 8-511.

(b) An entitlement holder's property interest with respect to a particular financial asset under subsection (a) is a pro rata property interest in all interests in that financial asset held by the securities intermediary, without regard to the time the entitlement holder acquired the security entitlement or the time the securities intermediary acquired the interest in that financial asset.

(c) An entitlement holder's property interest with respect to a particular financial asset under subsection (a) may be enforced against the securities intermediary only by exercise of the entitlement holder's rights under Sections 8-505 through 8-508.

(d) An entitlement holder's property interest with respect to a particular financial asset under subsection (a) may be enforced against a purchaser of the financial asset or interest therein only if:

(1) insolvency proceedings have been initiated by or against the securities intermediary;

(2) the securities intermediary does not have sufficient interests in the financial asset to satisfy the security entitlements of all of its entitlement holders to that financial asset;

(3) the securities intermediary violated its obligations under Section 8-504 by transferring the financial asset or interest therein to the purchaser; and

(4) the purchaser is not protected under subsection (e).

The trustee or other liquidator, acting on behalf of all entitlement holders having security entitlements with respect to a particular financial asset, may recover the financial asset, or interest therein, from the purchaser. If the trustee or other liquidator elects not to pursue that right, an entitlement holder whose security entitlement remains unsatisfied has the right to recover its interest in the financial asset from the purchaser.

(e) An action based on the entitlement holder's property interest with respect to a particular financial asset under subsection (a), whether framed in conversion, replevin, constructive trust, equitable lien, or other theory, may not be asserted against any purchaser of a financial asset or interest therein who gives value, obtains control, and does not act in collusion with the securities intermediary in violating the securities intermediary's obligations under Section 8-504.

8-504. DUTY OF SECURITIES INTERMEDIARY TO MAINTAIN FINANCIAL ASSET.

(a) A securities intermediary shall promptly obtain and thereafter maintain a financial asset in a quantity corresponding to the aggregate of all security entitlements it has established in favor of its entitlement holders with respect to that financial asset. The securities intermediary may maintain those financial assets directly or through one or more other securities intermediaries.

(b) Except to the extent otherwise agreed by its entitlement holder, a securities intermediary may not grant any security interests in a financial asset it is obligated to maintain pursuant to subsection (a).

(c) A securities intermediary satisfies the duty in subsection (a) if:

(1) the securities intermediary acts with respect to the duty as agreed upon by the entitlement holder and the securities intermediary; or

(2) in the absence of agreement, the securities intermediary exercises due care in accordance with reasonable commercial standards to obtain and maintain the financial asset.

(d) This section does not apply to a clearing corporation that is itself the obligor of an option or similar obligation to which its entitlement holders have security entitlements.

8-505. DUTY OF SECURITIES INTERMEDIARY WITH RESPECT TO PAYMENTS AND DISTRIBUTIONS.

(a) A securities intermediary shall take action to obtain a payment or distribution made by the issuer of a financial asset. A securities intermediary satisfies the duty if:

(1) the securities intermediary acts with respect to the duty as agreed upon by the entitlement holder and the securities intermediary; or

(2) in the absence of agreement, the securities intermediary exercises due care in accordance with reasonable commercial standards to attempt to obtain the payment or distribution.

(b) A securities intermediary is obligated to its entitlement holder for a payment or distribution made by the issuer of a financial asset if the payment or distribution is received by the securities intermediary.

8-506. DUTY OF SECURITIES INTERMEDIARY TO EXERCISE RIGHTS AS DIRECTED BY ENTITLEMENT HOLDER.

A securities intermediary shall exercise rights with respect to a financial asset if directed to do so by an entitlement holder. A securities intermediary satisfies the duty if:

(1) the securities intermediary acts with respect to the duty as agreed upon by the entitlement holder and the securities intermediary; or

(2) in the absence of agreement, the securities intermediary either places the entitlement holder in a position to exercise the rights directly or exercises due care in accordance with reasonable commercial standards to follow the direction of the entitlement holder.

8-507. DUTY OF SECURITIES INTERMEDIARY TO COMPLY WITH ENTITLEMENT ORDER.

(a) A securities intermediary shall comply with an entitlement order if the entitlement order is originated by the appropriate person, the securities intermediary has had reasonable opportunity to assure itself that the entitlement order is genuine and authorized, and the securities intermediary has had reasonable opportunity to comply with the entitlement order. A securities intermediary satisfies the duty if:

(1) the securities intermediary acts with respect to the duty as agreed upon by the entitlement holder and the securities intermediary; or

(2) in the absence of agreement, the securities intermediary exercises due care in accordance with reasonable commercial standards to comply with the entitlement order.

(b) If a securities intermediary transfers a financial asset pursuant to an ineffective entitlement order, the securities intermediary shall reestablish a security entitlement in favor of the person entitled to it, and pay or credit any payments or distributions that the person did not receive as a result of the wrongful transfer. If the securities intermediary does not reestablish a security entitlement, the securities intermediary is liable to the entitlement holder for damages.

8-508. DUTY OF SECURITIES INTERMEDIARY TO CHANGE ENTITLEMENT HOLDER'S POSITION TO OTHER FORM OF SECURITY HOLDING.

A securities intermediary shall act at the direction of an entitlement holder to change a security entitlement into another available form of holding for which the entitlement holder is eligible, or to cause the financial asset to be transferred to a securities account of the entitlement holder with another securities intermediary. A securities intermediary satisfies the duty if:

(1) the securities intermediary acts as agreed upon by the entitlement holder and the securities intermediary; or

(2) in the absence of agreement, the securities intermediary exercises due care in accordance with reasonable commercial standards to follow the direction of the entitlement holder.

8-509. SPECIFICATION OF DUTIES OF SECURITIES INTERMEDIARY BY OTHER STATUTE OR REGULATION; MANNER OF PERFORMANCE OF DUTIES OF SECURITIES INTERMEDIARY AND EXERCISE OF RIGHTS OF ENTITLEMENT HOLDER.

(a) If the substance of a duty imposed upon a securities intermediary by Sections 8-504 through 8-508 is the subject of other statute, regulation, or rule, compliance with that statute, regulation, or rule satisfies the duty.

(b) To the extent that specific standards for the performance of the duties of a securities intermediary or the exercise of the rights of an entitlement holder are not specified by other statute, regulation, or rule or by agreement between the securities intermediary and entitlement holder, the securities intermediary shall perform its duties and the entitlement holder shall exercise its rights in a commercially reasonable manner.

(c) The obligation of a securities intermediary to perform the duties imposed by Sections 8-504 through 8-508 is subject to:

(1) rights of the securities intermediary arising out of a security interest under a security agreement with the entitlement holder or otherwise; and

(2) rights of the securities intermediary under other law, regulation, rule, or agreement to withhold performance of its duties as a result of unfulfilled obligations of the entitlement holder to the securities intermediary.

(d) Sections 8-504 through 8-508 do not require a securities intermediary to take any action that is prohibited by other statute, regulation, or rule.

8-510. RIGHTS OF PURCHASER OF SECURITY ENTITLEMENT FROM ENTITLEMENT HOLDER.

(a) In a case not covered by the priority rules in Article 9 or the rules stated in subsection (c), an action based on an adverse claim to a financial asset or security entitlement, whether framed in conversion, replevin, constructive trust, equitable lien, or other theory, may not be asserted against a person who purchases a security entitlement, or an interest therein, from an entitlement holder if the purchaser gives value, does not have notice of the adverse claim, and obtains control.

(b) If an adverse claim could not have been asserted against an entitlement holder under Section 8-502, the adverse claim cannot be asserted against a person who purchases a security entitlement, or an interest therein, from the entitlement holder.

(c) In a case not covered by the priority rules in Article 9, a purchaser for value of a security entitlement, or an interest therein, who obtains control has priority over a purchaser of a security entitlement, or an interest therein, who does not obtain control. Except as otherwise provided in subsection (d), purchasers who have control rank according to priority in time of:

(1) the purchaser's becoming the person for whom the securities account, in which the security entitlement is carried, is maintained, if the purchaser obtained control under Section 8-106(d)(1);

(2) the securities intermediary's agreement to comply with the purchaser's entitlement orders with respect to security entitlements carried or to be carried in the securities account in which the security entitlement is carried, if the purchaser obtained control under Section 8-106(d)(2); or

(3) if the purchaser obtained control through another person under Section 8-106(d)(3), the time on which priority would be based under this subsection if the other person were the secured party.

(d) A securities intermediary as purchaser has priority over a conflicting purchaser who has control unless otherwise agreed by the securities intermediary.

8-511. PRIORITY AMONG SECURITY INTERESTS AND ENTITLEMENT HOLDERS.

(a) Except as otherwise provided in subsections (b) and (c), if a securities intermediary does not have sufficient interests in a particular financial asset to satisfy both its obligations to entitlement holders who have security entitlements to that financial asset and its obligation to a creditor of the securities intermediary who has a security interest in that financial asset, the claims of entitlement holders, other than the creditor, have priority over the claim of the creditor.

(b) A claim of a creditor of a securities intermediary who has a security interest in a financial asset held by a securities intermediary has priority over claims of the securities intermediary's entitlement holders who have security entitlements with respect to that financial asset if the creditor has control over the financial asset.

(c) If a clearing corporation does not have sufficient financial assets to satisfy both its obligations to entitlement holders who have security entitlements with respect to a financial asset and its obligation to a creditor of the clearing corporation who has a security interest in that financial asset, the claim of the creditor has priority over the claims of entitlement holders.

PART 6. TRANSITION PROVISIONS FOR REVISED ARTICLE 8 AND CONFORMING AMENDMENTS TO ARTICLES 1, 4, 5, 9, AND 10 [Table of Contents]

8-601. EFFECTIVE DATE.

This [Act] takes effect ... .

8-602. REPEALS.

This [Act] repeals ... .

8-603. SAVINGS CLAUSE.

(a) This [Act] does not affect an action or proceeding commenced before this [Act] takes effect.

(b) If a security interest in a security is perfected at the date this [Act] takes effect, and the action by which the security interest was perfected would suffice to perfect a security interest under this [Act], no further action is required to continue perfection. If a security interest in a security is perfected at the date this [Act] takes effect but the action by which the security interest was perfected would not suffice to perfect a security interest under this [Act].

The security interest remains perfected for a period of four months after the effective date and continues perfected thereafter if appropriate action to perfect under this [Act] is taken within that

period. If a security interest is perfected at the date this [Act] takes effect and the security interest can be perfected by filing under this [Act], a financing statement signed by the secured party instead of the debtor may be filed within that period to continue perfection or thereafter to perfect.

ARTICLE 9 - SECURED TRANSACTIONS

Part 1. General Provisions

[Subpart 1. Short Title, Definitions, and General Concepts]

9-101. SHORT TITLE.

This article may be cited as Uniform Commercial Code-Secured Transactions.

9-102. DEFINITIONS AND INDEX OF DEFINITIONS.

a.

In this article:

(1) "**Accession**" means goods that are physically united with other goods in such a manner that the identity of the original goods is not lost.

(2) "**Account**", except as used in "account for", means a right to payment of a monetary obligation, whether or not earned by performance, (i) for property that has been or is to be sold, leased, licensed, assigned, or otherwise disposed of, (ii) for services rendered or to be rendered, (iii) for a policy of insurance issued or to be issued, (iv) for a secondary obligation incurred or to be incurred, (v) for energy provided or to be provided, (vi) for the use or hire of a vessel under a charter or other contract, (vii) arising out of the use of a credit or charge card, and

or information contained on or for use with the card, or (viii) as winnings in a lottery or other game of chance operated or sponsored by a State, governmental unit of a State, or person licensed or authorized to operate the game by a State or governmental unit of a State. The term includes health-care-insurance receivables. The term does not include (i) rights to payment evidenced by chattel paper or an instrument, (ii) commercial tort claims, (iii) deposit accounts, (iv) investment property, (v) letter-of-credit rights or letters of credit, or (vi) rights to payment for money or funds advanced or sold, other than rights arising out of the use of a credit or charge card or information contained on or for use with the card.

(3) "**Account debtor**" means a person obligated on an account, chattel paper, or general intangible. The term does not include persons obligated to pay a negotiable instrument, even if the instrument constitutes part of chattel paper.

(4) "**Accounting**", except as used in "accounting for", means a record:

(A) authenticated by a secured party;

(B) indicating the aggregate unpaid secured obligations as of a date not more than 35 days earlier or 35 days later than the date of the record; and

(C) identifying the components of the obligations in reasonable detail.

(5) "**Agricultural lien**" means an interest, other than a security interest, in farm products:

(A) which secures payment or performance of an obligation for:

(i) goods or services furnished in connection with a debtor's farming operation; or

(ii) rent on real property leased by a debtor in connection with its farming operation;

(B) which is created by statute in favor of a person that:

(i) in the ordinary course of its business furnished goods or services to a debtor in connection with a debtor's farming operation; or

(ii) leased real property to a debtor in connection with the debtor's farming operation; and

(C) whose effectiveness does not depend on the person's possession of the personal property.

(6) "**As-extracted collateral**" means:

(A) oil, gas, or other minerals that are subject to a security interest that:

(i) is created by a debtor having an interest in the minerals before extraction; and

(ii) attaches to the minerals as extracted; or

(B) accounts arising out of the sale at the wellhead or minehead of oil, gas, or other minerals in which the debtor had an interest before extraction.

(7) "**Authenticate**" means:

(A) to sign; or

(B) to execute or otherwise adopt a symbol, or encrypt or similarly process a record in whole or in part, with the present intent of the authenticating person to identify the person and adopt or accept a record.

(8) "**Bank**" means an organization that is engaged in the business of banking. The term includes savings banks, savings and loan associations, credit unions, and trust companies.

(9) "**Cash proceeds**" means proceeds that are money, checks, deposit accounts, or the like.

(10) "**Certificate of title**" means a certificate of title with respect to which a statute provides for the security interest in question to be indicated on the certificate as a condition or result of the security interest's obtaining priority over the rights of a lien creditor with respect to the collateral.

(11) "**Chattel paper**" means a record or records that evidence both a monetary obligation and a security interest in specific goods, a security interest in specific goods and software used in the goods, a security interest in specific goods and license of software used in the goods, a lease of specific goods, or a lease of specific goods and license of software used in the goods. In this paragraph, "monetary obligation" means a monetary obligation secured by the goods or owed under a lease of the goods and includes a monetary obligation with respect to software used in the goods. The term does not include (i) charters or other contracts involving the use or hire of a vessel or (ii) records that evidence a right to payment arising out of the use of a credit or charge card or information contained on or for use with the card. If a transaction is evidenced by records that include an instrument or series of instruments, the group of records taken together constitutes chattel paper.

(12) "**Collateral**" means the property subject to a security interest or agricultural lien. The term includes:

(A) proceeds to which a security interest attaches;

(B) accounts, chattel paper, payment intangibles, and promissory notes that have been sold; and

(C) goods that are the subject of a consignment.

(13) "**Commercial tort claim**" means a claim arising in tort with respect to which:

(A) the claimant is an organization; or

(B) the claimant is an individual and the claim:

(i) arose in the course of the claimant's business or profession; and

(ii) does not include damages arising out of personal injury to or the death of an individual.

(14) "**Commodity account**" means an account maintained by a commodity intermediary in which a commodity contract is carried for a commodity customer.

(15) "**Commodity contract**" means a commodity futures contract, an option on a commodity futures contract, a commodity option, or another contract if the contract or option is:

(A) traded on or subject to the rules of a board of trade that has been designated as a contract market for such a contract pursuant to federal commodities laws; or

(B) traded on a foreign commodity board of trade, exchange, or market, and is carried on the books of a commodity intermediary for a commodity customer.

(16) "**Commodity customer**" means a person for which a commodity intermediary carries a commodity contract on its books.

(17) "**Commodity intermediary**" means a person that:

(A) is registered as a futures commission merchant under federal commodities law; or

(B) in the ordinary course of its business provides clearance or settlement services for a board of trade that has been designated as a contract market pursuant to federal commodities law.

(18) "**Communicate**" means:

(A) to send a written or other tangible record;

(B) to transmit a record by any means agreed upon by the persons sending and receiving the record; or

(C) in the case of transmission of a record to or by a filing office, to transmit a record by any means prescribed by filing-office rule.

(19) "**Consignee**" means a merchant to which goods are delivered in a consignment.

(20) "**Consignment**" means a transaction, regardless of its form, in which a person delivers goods to a merchant for the purpose of sale and:

(A) the merchant:

(i) deals in goods of that kind under a name other than the name of the person making delivery;

(ii) is not an auctioneer; and

(iii) is not generally known by its creditors to be substantially engaged in selling the goods of others;

(B) with respect to each delivery, the aggregate value of the goods is $1,000 or more at the time of delivery;

(C) the goods are not consumer goods immediately before delivery; and

(D) the transaction does not create a security interest that secures an obligation.

(21) "**Consignor**" means a person that delivers goods to a consignee in a consignment.

(22) "**Consumer debtor**" means a debtor in a consumer transaction.

(23) "**Consumer goods**" means goods that are used or bought for use primarily for personal, family, or household purposes.

(24) "**Consumer-goods transaction**" means a consumer transaction in which:

(A) an individual incurs an obligation primarily for personal, family, or household purposes; and

(B) a security interest in consumer goods secures the obligation.

(25) "**Consumer obligor**" means an obligor who is an individual and who incurred the obligation as part of a transaction entered into primarily for personal, family, or household purposes.

(26) "**Consumer transaction**" means a transaction in which (i) an individual incurs an obligation primarily for personal, family, or household purposes, (ii) a security interest secures the obligation, and (iii) the collateral is held or acquired primarily for personal, family, or household purposes. The term includes consumer-goods transactions.

(27) "**Continuation statement**" means an amendment of a financing statement which:

(A) identifies, by its file number, the initial financing statement to which it relates; and

(B) indicates that it is a continuation statement for, or that it is filed to continue the effectiveness of, the identified financing statement.

(28) "**Debtor**" means:

(A) a person having an interest, other than a security interest or other lien, in the collateral, whether or not the person is an obligor;

(B) a seller of accounts, chattel paper, payment intangibles, or promissory notes; or

(C) a consignee.

(29) "**Deposit account**" means a demand, time, savings, passbook, or similar account maintained with a bank. The term does not include investment property or accounts evidenced by an instrument.

(30) "**Document**" means a document of title or a receipt of the type described in Section 7-201(2).

(31) "**Electronic chattel paper**" means chattel paper evidenced by a record or records consisting of information stored in an electronic medium.

(32) "**Encumbrance**" means a right, other than an ownership interest, in real property. The term includes mortgages and other liens on real property.

(33) "**Equipment**" means goods other than inventory, farm products, or consumer goods.

(34) "**Farm products**" means goods, other than standing timber, with respect to which the debtor is engaged in a farming operation and which are:

(A) crops grown, growing, or to be grown, including:

(i) crops produced on trees, vines, and bushes; and

(ii) aquatic goods produced in aquacultural operations;

(B) livestock, born or unborn, including aquatic goods produced in aquacultural operations;

(C) supplies used or produced in a farming operation; or

(D) products of crops or livestock in their unmanufactured states.

(35) "**Farming operation**" means raising, cultivating, propagating, fattening, grazing, or any other farming, livestock, or aquacultural operation.

(36) "**File number**" means the number assigned to an initial financing statement pursuant to Section 9-519(a).

(37) "**Filing office**" means an office designated in Section 9-501 as the place to file a financing statement.

(38) "**Filing-office rule**" means a rule adopted pursuant to Section 9-526.

(39) "**Financing statement**" means a record or records composed of an initial financing statement and any filed record relating to the initial financing statement.

(40) "**Fixture filing**" means the filing of a financing statement covering goods that are or are to become fixtures and satisfying Section 9-502(a) and (b). The term includes the filing of a financing statement covering goods of a transmitting utility which are or are to become fixtures.

(41) "**Fixtures**" means goods that have become so related to particular real property that an interest in them arises under real property law.

(42) "**General intangible**" means any personal property, including things in action, other than accounts, chattel paper, commercial tort claims, deposit accounts, documents, goods, instruments, investment property, letter-of-credit rights, letters of credit, money, and oil, gas, or other minerals before extraction. The term includes payment intangibles and software.

(43) "Good faith" means honesty in fact and the observance of reasonable commercial standards of fair dealing.

(44) "**Goods**" means all things that are movable when a security interest attaches. The term includes (i) fixtures, (ii) standing timber that is to be cut and removed under a conveyance or contract for sale, (iii) the unborn young of animals, (iv) crops grown, growing, or to be grown, even if the crops are produced on trees, vines, or bushes, and (v) manufactured homes. The term also includes a computer program embedded in goods and any supporting information provided in connection with a transaction relating to the program if (i) the program is associated with the goods in such a manner that it customarily is considered part of the goods, or (ii) by becoming the owner of the goods, a person acquires a right to use the program in connection with the goods. The term does not include a computer program embedded in goods that consist solely of the medium in which the program is embedded. The term also does not include accounts, chattel paper, commercial tort claims, deposit accounts, documents, general intangibles, instruments, investment property, letter-of-credit rights, letters of credit, money, or oil, gas, or other minerals before extraction.

(45) "**Governmental unit**" means a subdivision, agency, department, county, parish, municipality, or other unit of the government of the United States, a State, or a foreign country. The term includes an organization having a separate corporate existence if the organization is eligible to issue debt on which interest is exempt from income taxation under the laws of the United States.

(46) "**Health-care-insurance receivable**" means an interest in or claim under a policy of insurance which is a right to payment of a monetary obligation for health-care goods or services provided.

(47) "**Instrument**" means a negotiable instrument or any other writing that evidences a right to the payment of a monetary obligation, is not itself a security agreement or lease, and is of a type that in ordinary course of business is transferred by delivery with any necessary indorsement or assignment. The term does not include (i) investment property, (ii) letters of credit, or (iii) writings that evidence a right to payment arising out of the use of a credit or charge card or information contained on or for use with the card.

(48) "**Inventory**" means goods, other than farm products, which:

(A) are leased by a person as lessor;

(B) are held by a person for sale or lease or to be furnished under a contract of service;

(C) are furnished by a person under a contract of service; or

(D) consist of raw materials, work in process, or materials used or consumed in a business.

(49) "**Investment property**" means a security, whether certificated or uncertificated, security entitlement, securities account, commodity contract, or commodity account.

(50) "**Jurisdiction of organization**", with respect to a registered organization, means the jurisdiction under whose law the organization is organized.

(51) "**Letter-of-credit right**" means a right to payment or performance under a letter of credit, whether or not the beneficiary has demanded or is at the time entitled to demand payment or performance. The term does not include the right of a beneficiary to demand payment or performance under a letter of credit.

(52) "**Lien creditor**" means:

(A) a creditor that has acquired a lien on the property involved by attachment, levy, or the like;

(B) an assignee for benefit of creditors from the time of assignment;

(C) a trustee in bankruptcy from the date of the filing of the petition; or

(D) a receiver in equity from the time of appointment.

(53) "**Manufactured home**" means a structure, transportable in one or more sections, which, in the traveling mode, is eight body feet or more in width or 40 body feet or more in length, or, when erected on site, is 320 or more square feet, and which is built on a permanent chassis and designed to be used as a dwelling with or without a permanent foundation when connected to the required utilities, and includes the plumbing, heating, air-conditioning, and electrical systems contained therein.

The term includes any structure that meets all of the requirements of this paragraph except the size requirements and with respect to which the manufacturer voluntarily files a certification required by the United States Secretary of Housing and Urban Development and complies with the standards established under Title 42 of the United States Code.

(54) "**Manufactured-home transaction**" means a secured transaction:

(A) that creates a purchase-money security interest in a manufactured home, other than a manufactured home held as inventory; or

(B) in which a manufactured home, other than a manufactured home held as inventory, is the primary collateral.

(55) "**Mortgage**" means a consensual interest in real property, including fixtures, which secures payment or performance of an obligation.

(56) "**New debtor**" means a person that becomes bound as debtor under Section 9-203(d) by a security agreement previously entered into by another person.

(57) "**New value**" means (i) money, (ii) money's worth in property, services, or new credit, or (iii) release by a transferee of an interest in property previously transferred to the transferee. The term does not include an obligation substituted for another obligation.

(58) "**Noncash proceeds**" means proceeds other than cash proceeds.

(59) "**Obligor**" means a person that, with respect to an obligation secured by a security interest in or an agricultural lien on the collateral, (i) owes payment or other performance of the obligation, (ii) has provided property other than the collateral to secure payment or other performance of the obligation, or (iii) is otherwise accountable in whole or in part for payment or other performance of the obligation. The term does not include issuers or nominated persons under a letter of credit.

(60) "**Original debtor**", except as used in Section 9-310(c), means a person that, as debtor, entered into a security agreement to which a new debtor has become bound under Section 9-203(d).

(61) "**Payment intangible**" means a general intangible under which the account debtor's principal obligation is a monetary obligation.

(62) "**Person related to**", with respect to an individual, means:

(A) the spouse of the individual;

(B) a brother, brother-in-law, sister, or sister-in-law of the individual;

(C) an ancestor or lineal descendant of the individual or the individual's spouse; or

(D) any other relative, by blood or marriage, of the individual or the individual's spouse who shares the same home with the individual.

(63) "**Person related to**", with respect to an organization, means:

(A) a person directly or indirectly controlling, controlled by, or under common control with the organization;

(B) an officer or director of, or a person performing similar functions with respect to, the organization;

(C) an officer or director of, or a person performing similar functions with respect to, a person described in subparagraph (A);

(D) the spouse of an individual described in subparagraph (A), (B), or (C); or

(E) an individual who is related by blood or marriage to an individual described in subparagraph (A), (B), (C), or (D) and shares the same home with the individual.

(64) "**Proceeds**", except as used in Section 9-609(b), means the following property:

(A) whatever is acquired upon the sale, lease, license, exchange, or other disposition of collateral;

(B) whatever is collected on, or distributed on account of, collateral;

(C) rights arising out of collateral;

(D) to the extent of the value of collateral, claims arising out of the loss, nonconformity, or interference with the use of, defects or infringement of rights in, or damage to, the collateral; or

(E) to the extent of the value of collateral and to the extent payable to the debtor or the secured party, insurance payable by reason of the loss or nonconformity of, defects or infringement of rights in, or damage to, the collateral.

(65) "**Promissory note**" means an instrument that evidences a promise to pay a monetary obligation, does not evidence an order to pay, and does not contain an acknowledgment by a bank that the bank has received for deposit a sum of money or funds.

(66) "**Proposal**" means a record authenticated by a secured party which includes the terms on which the secured party is willing to accept collateral in full or partial satisfaction of the obligation it secures pursuant to Sections 9-620, 9-621, and 9-622.

(67) "**Public-finance transaction**" means a secured transaction in connection with which:

(A) debt securities are issued;

(B) all or a portion of the securities issued have an initial stated maturity of at least 20 years; and

(C) the debtor, obligor, secured party, account debtor or other person obligated on collateral, assignor or assignee of a secured obligation, or assignor or assignee of a security interest is a State or a governmental unit of a State.

(68) "**Pursuant to commitment**", with respect to an advance made or other value given by a secured party, means pursuant to the secured party's obligation, whether or not a subsequent event of default or other event not within the secured party's control has relieved or may relieve the secured party from its obligation.

(69) "**Record**", except as used in "for record", "of record", "record or legal title", and "record owner", means information that is inscribed on a tangible medium or which is stored in an electronic or other medium and is retrievable in perceivable form.

(70) "**Registered organization**" means an organization organized solely under the law of a single State or the United States and as to which the State or the United States must maintain a public record showing the organization to have been organized.

(71) "**Secondary obligor**" means an obligor to the extent that:

(A) the obligor's obligation is secondary; or

(B) the obligor has a right of recourse with respect to an obligation secured by collateral against the debtor, another obligor, or property of either.

(72) "**Secured party**" means:

(A) a person in whose favor a security interest is created or provided for under a security agreement, whether or not any obligation to be secured is outstanding;

(B) a person that holds an agricultural lien;

(C) a consignor;

(D) a person to which accounts, chattel paper, payment intangibles, or promissory notes have been sold;

(E) a trustee, indenture trustee, agent, collateral agent, or other representative in whose favor a security interest or agricultural lien is created or provided for; or

(F) a person that holds a security interest arising under Section 2-401, 2-505, 2-711(3), 2A-508(5), 4-210, or 5-118.

(73) "**Security agreement**" means an agreement that creates or provides for a security interest.

(74) "**Send**", in connection with a record or notification, means:

(A) to deposit in the mail, deliver for transmission, or transmit by any other usual means of communication, with postage or cost of transmission provided for, addressed to any address reasonable under the circumstances; or

(B) to cause the record or notification to be received within the time that it would have been received if properly sent under subparagraph (A).

(75) "**Software**" means a computer program and any supporting information provided in connection with a transaction relating to the program. The term does not include a computer program that is included in the definition of goods.

(76) "**State**" means a State of the United States, the District of Columbia, Puerto Rico, the United States Virgin Islands, or any territory or insular possession subject to the jurisdiction of the United States.

(77) "**Supporting obligation**" means a letter-of-credit right or secondary obligation that supports the payment or performance of an account, chattel paper, a document, a general intangible, an instrument, or investment property.

(78) "**Tangible chattel paper**" means chattel paper evidenced by a record or records consisting of information that is inscribed on a tangible medium.

(79) "**Termination statement**" means an amendment of a financing statement which:

(A) identifies, by its file number, the initial financing statement to which it relates; and

(B) indicates either that it is a termination statement or that the identified financing statement is no longer effective.

(80) "**Transmitting utility**" means a person primarily engaged in the business of:

(A) operating a railroad, subway, street railway, or trolley bus;

(B) transmitting communications electrically, electromagnetically, or by light;

(C) transmitting goods by pipeline or sewer; or

(D) transmitting or producing and transmitting electricity, steam, gas, or water.

b. Definitions in other articles.

The following definitions in other articles apply to this article:

"**Applicant**"	Section 5-102.
"**Beneficiary**"	Section 5-102.
"**Broker**"	Section 8-102.
"**Certificated security**"	Section 8-102.
"**Check**"	Section 3-104.
"**Clearing corporation**"	Section 8-102.

"**Contract for sale**"	Section 2-106.
"**Customer**"	Section 4-104.
"**Entitlement holder**"	Section 8-102.
"**Financial asset**"	Section 8-102.
"**Holder in due course**"	Section 3-302.
"**Issuer**" (with respect to a letter of credit or letter-of-credit right)	Section 5-102.
"**Issuer**" (with respect to a security)	Section 8-201.
"**Issuer**" (with respect to documents of title)	Section 7-102.
"**Lease**"	Section 2A-103.
"**Lease agreement**"	Section 2A-103.
"**Lease contract**"	Section 2A-103.
"**Leasehold interest**"	Section 2A-103.
"**Lessee**"	Section 2A-103.
"**Lessee in ordinary course of business**"	Section 2A-103.
"**Lessor**"	Section 2A-103.
"**Lessor's residual interest**"	Section 2A-103.
"**Letter of credit**"	Section 5-102.
"**Merchant**"	Section 2-104.
"**Negotiable instrument**"	Section 3-104.
"**Nominated person**"	Section 5-102.
"**Note**"	Section 3-104.
"**Proceeds of a letter of credit**"	Section 5-114.
"**Prove**"	Section 3-103.
"**Sale**"	Section 2-106.
"**Securities account**"	Section 8-501.
"**Securities intermediary**"	Section 8-102.
"**Security**"	Section 8-102.
"**Security certificate**"	Section 8-102.
"**Security entitlement**"	Section 8-102.
"**Uncertificated security**"	Section 8-102.

c. Article 1 definitions and principles.

Article 1 contains general definitions and principles of construction and interpretation applicable throughout this article.

9-103. PURCHASE-MONEY SECURITY INTEREST; APPLICATION OF PAYMENTS; BURDEN OF ESTABLISHING.

(a) [Definitions.]

In this section:

(1) "purchase-money collateral" means goods or software that secures a purchase-money obligation incurred with respect to that collateral; and

(2) "purchase-money obligation" means an obligation of an obligor incurred as all or part of the price of the collateral or for value given to enable the debtor to acquire rights in or the use of the collateral if the value is in fact so used.

(b) [Purchase-money security interest in goods.]

A security interest in goods is a purchase-money security interest:

(1) to the extent that the goods are purchase-money collateral with respect to that security interest;

(2) if the security interest is in inventory that is or was purchase-money collateral, also to the extent that the security interest secures a purchase- money obligation incurred with respect to other inventory in which the secured party holds or held a purchase-money security interest; and

(3) also to the extent that the security interest secures a purchase-money obligation incurred with respect to software in which the secured party holds or held a purchase-money security interest.

(c) [Purchase-money security interest in software.]

A security interest in software is a purchase-money security interest to the extent that the security interest also secures a purchase-money obligation incurred with respect to goods in which the secured party holds or held a purchase-money security interest if:

(1) the debtor acquired its interest in the software in an integrated transaction in which it acquired an interest in the goods; and

(2) the debtor acquired its interest in the software for the principal purpose of using the software in the goods.

(d) [Consignor's inventory purchase-money security interest.]

The security interest of a consignor in goods that are the subject of a consignment is a purchase-money security interest in inventory.

(e) [Application of payment in non-consumer-goods transaction.]

In a transaction other than a consumer-goods transaction, if the extent to which a security interest is a purchase-money security interest depends on the application of a payment to a particular obligation, the payment must be applied:

(1) in accordance with any reasonable method of application to which the parties agree;

(2) in the absence of the parties' agreement to a reasonable method, in accordance with any intention of the obligor manifested at or before the time of payment; or

(3) in the absence of an agreement to a reasonable method and a timely manifestation of the obligor's intention, in the following order:

(A) to obligations that are not secured; and

(B) if more than one obligation is secured, to obligations secured by purchase-money security interests in the order in which those obligations were incurred.

(f) [No loss of status of purchase-money security interest in non-consumer-goods transaction.]

In a transaction other than a consumer-goods transaction, a purchase-money security interest does not lose its status as such, even if:

(1) the purchase-money collateral also secures an obligation that is not a purchase-money obligation;

(2) collateral that is not purchase-money collateral also secures the purchase-money obligation; or

(3) the purchase-money obligation has been renewed, refinanced, consolidated, or restructured.

(g) [Burden of proof in non-consumer-goods transaction.]

In a transaction other than a consumer-goods transaction, a secured party claiming a purchase-money security interest has the burden of establishing the extent to which the security interest is a purchase-money security interest.

(h) [Non-consumer-goods transactions; no inference.]

The limitation of the rules in subsections (e), (f), and (g) to transactions other than consumer-goods transactions is intended to leave to the court the determination of the proper rules in consumer-goods transactions. The court may not infer from that limitation the nature of the proper rule in consumer-goods transactions and may continue to apply established approaches.

9-104. CONTROL OF DEPOSIT ACCOUNT.

(a) [Requirements for control.]

A secured party has control of a deposit account if:

(1) the secured party is the bank with which the deposit account is maintained;

(2) the debtor, secured party, and bank have agreed in an authenticated record that the bank will comply with instructions originated by the secured party directing disposition of the funds in the deposit account without further consent by the debtor; or

(3) the secured party becomes the bank's customer with respect to the deposit account.

(b) [Debtor's right to direct disposition.]

A secured party that has satisfied subsection (a) has control, even if the debtor retains the right to direct the disposition of funds from the deposit account.

9-105. CONTROL OF ELECTRONIC CHATTEL PAPER.

A secured party has control of electronic chattel paper if the record or records comprising the chattel paper are created, stored, and assigned in such a manner that:

(1) a single authoritative copy of the record or records exists which is unique, identifiable and, except as otherwise provided in paragraphs (4), (5), and (6), unalterable;

(2) the authoritative copy identifies the secured party as the assignee of the record or records;

(3) the authoritative copy is communicated to and maintained by the secured party or its designated custodian;

(4) copies or revisions that add or change an identified assignee of the authoritative copy can be made only with the participation of the secured party;

(5) each copy of the authoritative copy and any copy of a copy is readily identifiable as a copy that is not the authoritative copy; and

(6) any revision of the authoritative copy is readily identifiable as an authorized or unauthorized revision.

9-106. CONTROL OF INVESTMENT PROPERTY.

(a) [Control under Section 8-106.]

A person has control of a certificated security, uncertificated security, or security entitlement as provided in Section 8-106.

(b) [Control of commodity contract.]

A secured party has control of a commodity contract if:

(1) the secured party is the commodity intermediary with which the commodity contract is carried; or

(2) the commodity customer, secured party, and commodity intermediary have agreed that the commodity intermediary will apply any value distributed on account of the commodity contract as directed by the secured party without further consent by the commodity customer.

(c) [Effect of control of securities account or commodity account.]

A secured party having control of all security entitlements or commodity contracts carried in a securities account or commodity account has control over the securities account or commodity account.

9-107. CONTROL OF LETTER-OF-CREDIT RIGHT.

A secured party has control of a letter-of-credit right to the extent of any right to payment or performance by the issuer or any nominated person if the issuer or nominated person has consented to an assignment of proceeds of the letter of credit under Section 5-114(c) or otherwise applicable law or practice.

9-108. SUFFICIENCY OF DESCRIPTION.

(a) [Sufficiency of description.]

Except as otherwise provided in subsections (c), (d), and (e), a description of personal or real property is sufficient, whether or not it is specific, if it reasonably identifies what is described.

(b) [Examples of reasonable identification.]

Except as otherwise provided in subsection (d), a description of collateral reasonably identifies the collateral if it identifies the collateral by:

(1) specific listing;

(2) category;

(3) except as otherwise provided in subsection (e), a type of collateral defined in [the Uniform Commercial Code];

(4) quantity;

(5) computational or allocational formula or procedure; or

(6) except as otherwise provided in subsection (c), any other method, if the identity of the collateral is objectively determinable.

(c) [Supergeneric description not sufficient.]

A description of collateral as "all the debtor's assets" or "all the debtor's personal property" or using words of similar import does not reasonably identify the collateral.

(d) [Investment property.]

Except as otherwise provided in subsection (e), a description of a security entitlement, securities account, or commodity account is sufficient if it describes:

(1) the collateral by those terms or as investment property; or

(2) the underlying financial asset or commodity contract.

(e) [When description by type insufficient.]

A description only by type of collateral defined in [the Uniform Commercial Code] is an insufficient description of:

(1) a commercial tort claim; or

(2) in a consumer transaction, consumer goods, a security entitlement, a securities account, or a commodity account.

[Subpart 2. Applicability of Article] [Table of Contents]

9-109. SCOPE.

(a) [General scope of article.]

Except as otherwise provided in subsections (c) and (d), this article applies to:

(1) a transaction, regardless of its form, that creates a security interest in personal property or fixtures by contract;

(2) an agricultural lien;

(3) a sale of accounts, chattel paper, payment intangibles, or promissory notes;

(4) a consignment;

(5) a security interest arising under Section 2-401, 2-505, 2-711(3), or 2A-508(5), as provided in Section 9-110; and

(6) a security interest arising under Section 4-210 or 5-118.

(b) [Security interest in secured obligation.]

The application of this article to a security interest in a secured obligation is not affected by the fact that the obligation is itself secured by a transaction or interest to which this article does not apply.

(c) [Extent to which article does not apply.]

This article does not apply to the extent that:

(1) a statute, regulation, or treaty of the United States preempts this article;

(2) another statute of this State expressly governs the creation, perfection, priority, or enforcement of a security interest created by this State or a governmental unit of this State;

(3) a statute of another State, a foreign country, or a governmental unit of another State or a foreign country, other than a statute generally applicable to security interests, expressly governs creation, perfection, priority, or enforcement of a security interest created by the State, country, or governmental unit; or

(4) the rights of a transferee beneficiary or nominated person under a letter of credit are independent and superior under Section 5-114.

(d) [Inapplicability of article.]

This article does not apply to:

(1) a landlord's lien, other than an agricultural lien;

(2) a lien, other than an agricultural lien, given by statute or other rule of law for services or materials, but Section 9-333 applies with respect to priority of the lien;

(3) an assignment of a claim for wages, salary, or other compensation of an employee;

(4) a sale of accounts, chattel paper, payment intangibles, or promissory notes as part of a sale of the business out of which they arose;

(5) an assignment of accounts, chattel paper, payment intangibles, or promissory notes which is for the purpose of collection only;

(6) an assignment of a right to payment under a contract to an assignee that is also obligated to perform under the contract;

(7) an assignment of a single account, payment intangible, or promissory note to an assignee in full or partial satisfaction of a preexisting indebtedness;

(8) a transfer of an interest in or an assignment of a claim under a policy of insurance, other than an assignment by or to a health-care provider of a health-care-insurance receivable and any subsequent assignment of the right to payment, but Sections 9-315 and 9-322 apply with respect to proceeds and priorities in proceeds;

(9) an assignment of a right represented by a judgment, other than a judgment taken on a right to payment that was collateral;

(10) a right of recoupment or set-off, but:

(A) Section 9-340 applies with respect to the effectiveness of rights of recoupment or set-off against deposit accounts; and

(B) Section 9-404 applies with respect to defenses or claims of an account debtor;

(11) the creation or transfer of an interest in or lien on real property, including a lease or rents thereunder, except to the extent that provision is made for:

(A) liens on real property in Sections 9-203 and 9-308;

(B) fixtures in Section 9-334;

(C) fixture filings in Sections 9-501, 9-502, 9-512, 9-516, and 9-519; and

(D) security agreements covering personal and real property in Section 9-604;

(12) an assignment of a claim arising in tort, other than a commercial tort claim, but Sections 9-315 and 9-322 apply with respect to proceeds and priorities in proceeds; or

(13) an assignment of a deposit account in a consumer transaction, but Sections 9-315 and 9-322 apply with respect to proceeds and priorities in proceeds.

9-110. SECURITY INTERESTS ARISING UNDER ARTICLE 2 OR 2A.

A security interest arising under Section 2-401, 2-505, 2-711(3), or 2A-508(5) is subject to this article. However, until the debtor obtains possession of the goods:

(1) the security interest is enforceable, even if Section 9-203(b)(3) has not been satisfied;

(2) filing is not required to perfect the security interest;

(3) the rights of the secured party after default by the debtor are governed by Article 2 or 2A; and

(4) the security interest has priority over a conflicting security interest created by the debtor.

Part 2. Effectiveness of Security Agreement; Attachment of Security Interest; Rights of Parties to Security Agreement [Table of Contents]

[Subpart 1. Effectiveness and Attachment] [Table of Contents]

9-201. GENERAL EFFECTIVENESS OF SECURITY AGREEMENT.

(a) [General effectiveness.]

Except as otherwise provided in [the Uniform Commercial Code], a security agreement is effective according to its terms between the parties, against purchasers of the collateral, and against creditors.

(b) [Applicable consumer laws and other law.]

A transaction subject to this article is subject to any applicable rule of law which establishes a different rule for consumers and [insert reference to (i) any other statute or regulation that regulates the rates, charges, agreements, and practices for loans, credit sales, or other extensions of credit and (ii) any consumer-protection statute or regulation].

(c) [Other applicable law controls.]

In case of conflict between this article and a rule of law, statute, or regulation described in subsection (b), the rule of law, statute, or regulation controls. Failure to comply with a statute or regulation described in subsection (b) has only the effect the statute or regulation specifies.

(d) [Further deference to other applicable law.]

This article does not:

(1) validate any rate, charge, agreement, or practice that violates a rule of law, statute, or regulation described in subsection (b); or

(2) extend the application of the rule of law, statute, or regulation to a transaction not otherwise subject to it.

9-202. TITLE TO COLLATERAL IMMATERIAL.

Except as otherwise provided with respect to consignments or sales of accounts, chattel paper, payment intangibles, or promissory notes, the provisions of this article with regard to rights and obligations apply whether title to collateral is in the secured party or the debtor.

9-203. ATTACHMENT AND ENFORCEABILITY OF SECURITY INTEREST; PROCEEDS; SUPPORTING OBLIGATIONS; FORMAL REQUISITES.

(a) [Attachment.]

A security interest attaches to collateral when it becomes enforceable against the debtor with respect to the collateral, unless an agreement expressly postpones the time of attachment.

(b) [Enforceability.]

Except as otherwise provided in subsections (c) through (i), a security interest is enforceable against the debtor and third parties with respect to the collateral only if :

(1) value has been given;

(2) the debtor has rights in the collateral or the power to transfer rights in the collateral to a secured party; and

(3) one of the following conditions is met:

(A) the debtor has authenticated a security agreement that provides a description of the collateral and, if the security interest covers timber to be cut, a description of the land concerned;

(B) the collateral is not a certificated security and is in the possession of the secured party under Section 9-313 pursuant to the debtor's security agreement;

(C) the collateral is a certificated security in registered form and the security certificate has been delivered to the secured party under Section 8-301 pursuant to the debtor's security agreement; or

(D) the collateral is deposit accounts, electronic chattel paper, investment property, or letter-of-credit rights, and the secured party has control under Section 9-104, 9-105, 9-106, or 9-107 pursuant to the debtor's security agreement.

(c) [Other UCC provisions.]

Subsection (b) is subject to Section 4-210 on the security interest of a collecting bank, Section 5-118 on the security interest of a letter-of-credit issuer or nominated person, Section 9-110 on a security interest arising under Article 2 or 2A, and Section 9-206 on security interests in investment property.

(d) [When person becomes bound by another person's security agreement.]

A person becomes bound as debtor by a security agreement entered into by another person if, by operation of law other than this article or by contract:

(1) the security agreement becomes effective to create a security interest in the person's property; or

(2) the person becomes generally obligated for the obligations of the other person, including the obligation secured under the security agreement, and acquires or succeeds to all or substantially all of the assets of the other person.

(e) [Effect of new debtor becoming bound.]

If a new debtor becomes bound as debtor by a security agreement entered into by another person:

(1) the agreement satisfies subsection (b)(3) with respect to existing or after-acquired property of the new debtor to the extent the property is described in the agreement; and

(2) another agreement is not necessary to make a security interest in the property enforceable.

(f) [Proceeds and supporting obligations.]

The attachment of a security interest in collateral gives the secured party the rights to proceeds provided by Section 9-315 and is also attachment of a security interest in a supporting obligation for the collateral.

(g) [Lien securing right to payment.]

The attachment of a security interest in a right to payment or performance secured by a security interest or other lien on personal or real property is also attachment of a security interest in the security interest, mortgage, or other lien.

(h) [Security entitlement carried in securities account.]

The attachment of a security interest in a securities account is also attachment of a security interest in the security entitlements carried in the securities account.

(i) [Commodity contracts carried in commodity account.]

The attachment of a security interest in a commodity account is also attachment of a security interest in the commodity contracts carried in the commodity account.

9-204. AFTER-ACQUIRED PROPERTY; FUTURE ADVANCES.

(a) [After-acquired collateral.]

Except as otherwise provided in subsection (b), a security agreement may create or provide for a security interest in after-acquired collateral.

(b) [When after-acquired property clause not effective.]

A security interest does not attach under a term constituting an after-acquired property clause to:

(1) consumer goods, other than an accession when given as additional security, unless the debtor acquires rights in them within 10 days after the secured party gives value; or

(2) a commercial tort claim.

(c) [Future advances and other value.]

A security agreement may provide that collateral secures, or that accounts, chattel paper, payment intangibles, or promissory notes are sold in connection with, future advances or other value, whether or not the advances or value are given pursuant to commitment.

9-205. USE OR DISPOSITION OF COLLATERAL PERMISSIBLE.

(a) [When security interest not invalid or fraudulent.]

A security interest is not invalid or fraudulent against creditors solely because:

(1) the debtor has the right or ability to:

(A) use, commingle, or dispose of all or part of the collateral, including returned or repossessed goods;

(B) collect, compromise, enforce, or otherwise deal with collateral;

(C) accept the return of collateral or make repossessions; or

(D) use, commingle, or dispose of proceeds; or

(2) the secured party fails to require the debtor to account for proceeds or replace collateral.

(b) [Requirements of possession not relaxed.]

This section does not relax the requirements of possession if attachment, perfection, or enforcement of a security interest depends upon possession of the collateral by the secured party.

9-206. SECURITY INTEREST ARISING IN PURCHASE OR DELIVERY OF FINANCIAL ASSET.

(a) [Security interest when person buys through securities intermediary.]

A security interest in favor of a securities intermediary attaches to a person's security entitlement if:

(1) the person buys a financial asset through the securities intermediary in a transaction in which the person is obligated to pay the purchase price to the securities intermediary at the time of the purchase; and

(2) the securities intermediary credits the financial asset to the buyer's securities account before the buyer pays the securities intermediary.

(b) [Security interest secures obligation to pay for financial asset.]

The security interest described in subsection (a) secures the person's obligation to pay for the financial asset.

(c) [Security interest in payment against delivery transaction.]

A security interest in favor of a person that delivers a certificated security or other financial asset represented by a writing attaches to the security or other financial asset if:

(1) the security or other financial asset:

(A) in the ordinary course of business is transferred by delivery with any necessary indorsement or assignment; and

(B) is delivered under an agreement between persons in the business of dealing with such securities or financial assets; and

(2) the agreement calls for delivery against payment.

(d) [Security interest secures obligation to pay for delivery.]

The security interest described in subsection (c) secures the obligation to make payment for the delivery.

[Subpart 2. Rights and Duties] [Table of Contents]

9-207. RIGHTS AND DUTIES OF SECURED PARTY HAVING POSSESSION OR CONTROL OF COLLATERAL.

(a) [Duty of care when secured party in possession.]

Except as otherwise provided in subsection (d), a secured party shall use reasonable care in the custody and preservation of collateral in the secured party's possession. In the case of chattel paper or an instrument, reasonable care includes taking necessary steps to preserve rights against prior parties unless otherwise agreed.

(b) [Expenses, risks, duties, and rights when secured party in possession.]

Except as otherwise provided in subsection (d), if a secured party has possession of collateral:

(1) reasonable expenses, including the cost of insurance and payment of taxes or other charges, incurred in the custody, preservation, use, or operation of the collateral are chargeable to the debtor and are secured by the collateral;

(2) the risk of accidental loss or damage is on the debtor to the extent of a deficiency in any effective insurance coverage;

(3) the secured party shall keep the collateral identifiable, but fungible collateral may be commingled; and

(4) the secured party may use or operate the collateral:

(A) for the purpose of preserving the collateral or its value;

(B) as permitted by an order of a court having competent jurisdiction; or

(C) except in the case of consumer goods, in the manner and to the extent agreed by the debtor.

(c) [Duties and rights when secured party in possession or control.]

Except as otherwise provided in subsection (d), a secured party having possession of collateral or control of collateral under Section 9-104, 9-105, 9-106, or 9-107:

(1) may hold as additional security any proceeds, except money or funds, received from the collateral;

(2) shall apply money or funds received from the collateral to reduce the secured obligation, unless remitted to the debtor; and

(3) may create a security interest in the collateral.

(d) [Buyer of certain rights to payment.]

If the secured party is a buyer of accounts, chattel paper, payment intangibles, or promissory notes or a consignor:

(1) subsection (a) does not apply unless the secured party is entitled under an agreement:

(A) to charge back uncollected collateral; or

(B) otherwise to full or limited recourse against the debtor or a secondary obligor based on the nonpayment or other default of an account debtor or other obligor on the collateral; and

(2) subsections (b) and (c) do not apply.

9-208. ADDITIONAL DUTIES OF SECURED PARTY HAVING CONTROL OF COLLATERAL.

(a) [Applicability of section.]

This section applies to cases in which there is no outstanding secured obligation and the secured party is not committed to make advances, incur obligations, or otherwise give value.

(b) [Duties of secured party after receiving demand from debtor.]

Within 10 days after receiving an authenticated demand by the debtor:

(1) a secured party having control of a deposit account under Section 9-104(a)(2) shall send to the bank with which the deposit account is maintained an authenticated statement that releases the bank from any further obligation to comply with instructions originated by the secured party;

(2) a secured party having control of a deposit account under Section 9-104(a)(3) shall:

(A) pay the debtor the balance on deposit in the deposit account; or

(B) transfer the balance on deposit into a deposit account in the debtor's name;

(3) a secured party, other than a buyer, having control of electronic chattel paper under Section 9-105 shall:

(A) communicate the authoritative copy of the electronic chattel paper to the debtor or its designated custodian;

(B) if the debtor designates a custodian that is the designated custodian with which the authoritative copy of the electronic chattel paper is maintained for the secured party, communicate to the custodian an authenticated record releasing the designated custodian from any further obligation to comply with instructions originated by the secured party and instructing the custodian to comply with instructions originated by the debtor; and

(C) take appropriate action to enable the debtor or its designated custodian to make copies of or revisions to the authoritative copy which add or change an identified assignee of the authoritative copy without the consent of the secured party;

(4) a secured party having control of investment property under Section 8-106(d)(2) or 9-106(b) shall send to the securities intermediary or commodity intermediary with which the security entitlement or commodity contract is maintained an authenticated record that releases the securities intermediary or commodity intermediary from any further obligation to comply with entitlement orders or directions originated by the secured party;

(5) a secured party having control of a letter-of-credit right under Section 9-107 shall send to each person having an unfulfilled obligation to pay or deliver proceeds of the letter of credit to the secured party an authenticated release from any further obligation to pay or deliver proceeds of the letter of credit to the secured party.

9-209. DUTIES OF SECURED PARTY IF ACCOUNT DEBTOR HAS BEEN NOTIFIED OF ASSIGNMENT.

(a) [Applicability of section.]

Except as otherwise provided in subsection (c), this section applies if:

(1) there is no outstanding secured obligation; and

(2) the secured party is not committed to make advances, incur obligations, or otherwise give value.

(b) [Duties of secured party after receiving demand from debtor.]

Within 10 days after receiving an authenticated demand by the debtor, a secured party shall send to an account debtor that has received notification of an assignment to the secured party as assignee under Section 9-406(a) an authenticated record that releases the account debtor from any further obligation to the secured party.

(c) [Inapplicability to sales.]

This section does not apply to an assignment constituting the sale of an account, chattel paper, or payment intangible.

9-210. REQUEST FOR ACCOUNTING; REQUEST REGARDING LIST OF COLLATERAL OR STATEMENT OF ACCOUNT.

(a) [Definitions.]

In this section:

(1) "Request" means a record of a type described in paragraph (2), (3), or (4).

(2) "Request for an accounting" means a record authenticated by a debtor requesting that the recipient provide an accounting of the unpaid obligations secured by collateral and reasonably identifying the transaction or relationship that is the subject of the request.

(3) "Request regarding a list of collateral" means a record authenticated by a debtor requesting that the recipient approve or correct a list of what the debtor believes to be the collateral securing an obligation and reasonably identifying the transaction or relationship that is the subject of the request.

(4) "Request regarding a statement of account" means a record authenticated by a debtor requesting that the recipient approve or correct a statement indicating what the debtor believes to be the aggregate amount of unpaid obligations secured by collateral as of a specified date and reasonably identifying the transaction or relationship that is the subject of the request.

(b) [Duty to respond to requests.]

Subject to subsections (c), (d), (e), and (f), a secured party, other than a buyer of accounts, chattel paper, payment intangibles, or promissory notes or a consignor, shall comply with a request within 14 days after receipt:

(1) in the case of a request for an accounting, by authenticating and sending to the debtor an accounting; and

(2) in the case of a request regarding a list of collateral or a request regarding a statement of account, by authenticating and sending to the debtor an approval or correction.

(c) [Request regarding list of collateral; statement concerning type of collateral.]

A secured party that claims a security interest in all of a particular type of collateral owned by the debtor may comply with a request regarding a list of collateral by sending to the debtor an authenticated record including a statement to that effect within 14 days after receipt.

(d) [Request regarding list of collateral; no interest claimed.]

A person that receives a request regarding a list of collateral, claims no interest in the collateral when it receives the request, and claimed an interest in the collateral at an earlier time shall comply with the request within 14 days after receipt by sending to the debtor an authenticated record:

(1) disclaiming any interest in the collateral; and

(2) if known to the recipient, providing the name and mailing address of any assignee of or successor to the recipient's interest in the collateral.

(e) [Request for accounting or regarding statement of account; no interest in obligation claimed.]

A person that receives a request for an accounting or a request regarding a statement of account, claims no interest in the obligations when it receives the request, and claimed an interest in the obligations at an earlier time shall comply with the request within 14 days after receipt by sending to the debtor an authenticated record:

(1) disclaiming any interest in the obligations; and

(2) if known to the recipient, providing the name and mailing address of any assignee of or successor to the recipient's interest in the obligations.

(f) [Charges for responses.]

A debtor is entitled without charge to one response to a request under this section during any six-month period. The secured party may require payment of a charge not exceeding $25 for each additional response.

Part 3. Perfection and Priority [Table of Contents]

[Subpart 1. Law Governing Perfection and Priority] [Table of Contents]

9-301. LAW GOVERNING PERFECTION AND PRIORITY OF SECURITY INTERESTS.

Except as otherwise provided in Sections 9-303 through 9-306, the following rules determine the law governing perfection, the effect of perfection or nonperfection, and the priority of a security interest in collateral:

(1) Except as otherwise provided in this section, while a debtor is located in a jurisdiction, the local law of that jurisdiction governs perfection, the effect of perfection or nonperfection, and the priority of a security interest in collateral.

(2) While collateral is located in a jurisdiction, the local law of that jurisdiction governs perfection, the effect of perfection or nonperfection, and the priority of a possessory security interest in that collateral.

(3) Except as otherwise provided in paragraph (4), while negotiable documents, goods, instruments, money, or tangible chattel paper is located in a jurisdiction, the local law of that jurisdiction governs:

(A) perfection of a security interest in the goods by filing a fixture filing;

(B) perfection of a security interest in timber to be cut; and

(C) the effect of perfection or nonperfection and the priority of a nonpossessory security interest in the collateral.

(4) The local law of the jurisdiction in which the wellhead or minehead is located governs perfection, the effect of perfection or nonperfection, and the priority of a security interest in as-extracted collateral.

9-302. LAW GOVERNING PERFECTION AND PRIORITY OF AGRICULTURAL LIENS.

While farm products are located in a jurisdiction, the local law of that jurisdiction governs perfection, the effect of perfection or nonperfection, and the priority of an agricultural lien on the farm products.

9-303. LAW GOVERNING PERFECTION AND PRIORITY OF SECURITY INTERESTS IN GOODS COVERED BY A CERTIFICATE OF TITLE.

(a) [Applicability of section.]

This section applies to goods covered by a certificate of title, even if there is no other relationship between the jurisdiction under whose certificate of title the goods are covered and the goods or the debtor.

(b) [When goods covered by certificate of title.]

Goods become covered by a certificate of title when a valid application for the certificate of title and the applicable fee are delivered to the appropriate authority. Goods cease to be covered by a certificate of title at the earlier of the time the certificate of title ceases to be effective under the law of the issuing jurisdiction or the time the goods become covered subsequently by a certificate of title issued by another jurisdiction.

(c) [Applicable law.]

The local law of the jurisdiction under whose certificate of title the goods are covered governs perfection, the effect of perfection or nonperfection, and the priority of a security interest in goods covered by a certificate of title from the time the goods become covered by the certificate of title until the goods cease to be covered by the certificate of title.

9-304. LAW GOVERNING PERFECTION AND PRIORITY OF SECURITY INTERESTS IN DEPOSIT ACCOUNTS.

(a) [Law of bank's jurisdiction governs.]

The local law of a bank's jurisdiction governs perfection, the effect of perfection or nonperfection, and the priority of a security interest in a deposit account maintained with that bank.

(b) [Bank's jurisdiction.]

The following rules determine a bank's jurisdiction for purposes of this part:

(1) If an agreement between the bank and the debtor governing the deposit account expressly provides that a particular jurisdiction is the bank's jurisdiction for purposes of this part, this article, or [the Uniform Commercial Code], that jurisdiction is the bank's jurisdiction.

(2) If paragraph (1) does not apply and an agreement between the bank and its customer governing the deposit account expressly provides that the agreement is governed by the law of a particular jurisdiction, that jurisdiction is the bank's jurisdiction.

(3) If neither paragraph (1) nor paragraph (2) applies and an agreement between the bank and its customer governing the deposit account expressly provides that the deposit account is maintained at an office in a particular jurisdiction, that jurisdiction is the bank's jurisdiction.

(4) If none of the preceding paragraphs applies, the bank's jurisdiction is the jurisdiction in which the office identified in an account statement as the office serving the customer's account is located.

(5) If none of the preceding paragraphs applies, the bank's jurisdiction is the jurisdiction in which the chief executive office of the bank is located.

9-305. LAW GOVERNING PERFECTION AND PRIORITY OF SECURITY INTERESTS IN INVESTMENT PROPERTY.

(a) [Governing law: general rules.]

Except as otherwise provided in subsection (c), the following rules apply:

(1) While a security certificate is located in a jurisdiction, the local law of that jurisdiction governs perfection, the effect of perfection or nonperfection, and the priority of a security interest in the certificated security represented thereby.

(2) The local law of the issuer's jurisdiction as specified in Section 8-110(d) governs perfection, the effect of perfection or nonperfection, and the priority of a security interest in an uncertificated security.

(3) The local law of the securities intermediary's jurisdiction as specified in Section 8-110(e) governs perfection, the effect of perfection or nonperfection, and the priority of a security interest in a security entitlement or securities account.

(4) The local law of the commodity intermediary's jurisdiction governs perfection, the effect of perfection or nonperfection, and the priority of a security interest in a commodity contract or commodity account.

(b) [Commodity intermediary's jurisdiction.]

The following rules determine a commodity intermediary's jurisdiction for purposes of this part:

(1) If an agreement between the commodity intermediary and commodity customer governing the commodity account expressly provides that a particular jurisdiction is the commodity intermediary's jurisdiction for purposes of this part, this article, or [the Uniform Commercial Code], that jurisdiction is the commodity intermediary's jurisdiction.

(2) If paragraph (1) does not apply and an agreement between the commodity intermediary and commodity customer governing the commodity account expressly provides that the agreement is governed by the law of a particular jurisdiction, that jurisdiction is the commodity intermediary's jurisdiction.

(3) If neither paragraph (1) nor paragraph (2) applies and an agreement between the commodity intermediary and commodity customer governing the commodity account expressly provides that the commodity account is maintained at an office in a particular jurisdiction, that jurisdiction is the commodity intermediary's jurisdiction.

(4) If none of the preceding paragraphs applies, the commodity intermediary's jurisdiction is the jurisdiction in which the office identified in an account statement as the office serving the commodity customer's account is located.

(5) If none of the preceding paragraphs applies, the commodity intermediary's jurisdiction is the jurisdiction in which the chief executive office of the commodity intermediary is located.

(c) [When perfection governed by law of jurisdiction where debtor located.]

The local law of the jurisdiction in which the debtor is located governs:

(1) perfection of a security interest in investment property by filing;

(2) automatic perfection of a security interest in investment property created by a broker or securities intermediary; and

(3) automatic perfection of a security interest in a commodity contract or commodity account created bya commodity intermediary.

9-306. LAW GOVERNING PERFECTION AND PRIORITY OF SECURITY INTERESTS IN LETTER-OF-CREDIT RIGHTS.

(a) [Governing law: issuer's or nominated person's jurisdiction.]

Subject to subsection (c), the local law of the issuer's jurisdiction or a nominated person's jurisdiction governs perfection, the effect of perfection or nonperfection, and the priority of a security interest in a letter-of-credit right if the issuer's jurisdiction or nominated person's jurisdiction is a State.

(b) [Issuer's or nominated person's jurisdiction.]

For purposes of this part, an issuer's jurisdiction or nominated person's jurisdiction is the jurisdiction whose law governs the liability of the issuer or nominated person with respect to the letter-of-credit right as provided in Section 5-116.

(c) [When section not applicable.]

This section does not apply to a security interest that is perfected only under Section 9-308(d).

9-307. LOCATION OF DEBTOR.

(a) ["Place of business."]

In this section, "place of business" means a place where a debtor conducts its affairs.

(b) [Debtor's location: general rules.]

Except as otherwise provided in this section, the following rules determine a debtor's location:

(1) A debtor who is an individual is located at the individual's principal residence.

(2) A debtor that is an organization and has only one place of business is located at its place of business.

(3) A debtor that is an organization and has more than one place of business is located at its chief executive office.

(c) [Limitation of applicability of subsection (b).]

Subsection (b) applies only if a debtor's residence, place of business, or chief executive office, as applicable, is located in a jurisdiction whose law generally requires information concerning the existence of a nonpossessory security interest to be made generally available in a filing, recording, or registration system as a condition or result of the security interest's obtaining priority over the rights of a lien creditor with respect to the collateral. If subsection (b) does not apply, the debtor is located in the District of Columbia.

(d) [Continuation of location: cessation of existence, etc.]

A person that ceases to exist, have a residence, or have a place of business continues to be located in the jurisdiction specified by subsections (b) and (c).

(e) [Location of registered organization organized under State law.]

A registered organization that is organized under the law of a State is located in that State.

(f) [Location of registered organization organized under federal law; bank branches and agencies.]

Except as otherwise provided in subsection (i), a registered organization that is organized under the law of the United States and a branch or agency of a bank that is not organized under the law of the United States or a State are located:

(1) in the State that the law of the United States designates, if the law designates a State of location;

(2) in the State that the registered organization, branch, or agency designates, if the law of the United States authorizes the registered organization, branch, or agency to designate its State of location; or

(3) in the District of Columbia, if neither paragraph (1) nor paragraph (2) applies.

(g) [Continuation of location: change in status of registered organization.]

A registered organization continues to be located in the jurisdiction specified by subsection (e) or (f) notwithstanding:

(1) the suspension, revocation, forfeiture, or lapse of the registered organization's status as such in its jurisdiction of organization; or

(2) the dissolution, winding up, or cancellation of the existence of the registered organization.

(h) [Location of United States.]

The United States is located in the District of Columbia.

(i) [Location of foreign bank branch or agency if licensed in only one state.]

A branch or agency of a bank that is not organized under the law of the United States or a State is located in the State in which the branch or agency is licensed, if all branches and agencies of the bank are licensed in only one State.

(j) [Location of foreign air carrier.]

A foreign air carrier under the Federal Aviation Act of 1958, as amended, is located at the designated office of the agent upon which service of process may be made on behalf of the carrier.

(k) [Section applies only to this part.]

This section applies only for purposes of this part.

9-308. WHEN SECURITY INTEREST OR AGRICULTURAL LIEN IS PERFECTED; CONTINUITY OF PERFECTION.

(a) [Perfection of security interest.]

Except as otherwise provided in this section and Section 9-309, a security interest is perfected if it has attached and all of the applicable requirements for perfection in Sections 9-310 through 9-316 have been satisfied. A security interest is perfected when it attaches if the applicable requirements are satisfied before the security interest attaches.

(b) [Perfection of agricultural lien.]

An agricultural lien is perfected if it has become effective and all of the applicable requirements for perfection in Section 9-310 have been satisfied. An agricultural lien is perfected when it becomes effective if the applicable requirements are satisfied before the agricultural lien becomes effective.

(c) [Continuous perfection; perfection by different methods.]

A security interest or agricultural lien is perfected continuously if it is originally perfected by one method under this article and is later perfected by another method under this article, without an intermediate period when it was unperfected.

(d) [Supporting obligation.]

Perfection of a security interest in collateral also perfects a security interest in a supporting obligation for the collateral.

(e) [Lien securing right to payment.]

Perfection of a security interest in a right to payment or performance also perfects a security interest in a security interest, mortgage, or other lien on personal or real property securing the right.

(f) [Security entitlement carried in securities account.]

Perfection of a security interest in a securities account also perfects a security interest in the security entitlements carried in the securities account.

(g) [Commodity contract carried in commodity account.]

Perfection of a security interest in a commodity account also perfects a security interest in the commodity contracts carried in the commodity account.

9-309. SECURITY INTEREST PERFECTED UPON ATTACHMENT.

The following security interests are perfected when they attach:

(1) a purchase-money security interest in consumer goods, except as otherwise provided in Section 9-311(b) with respect to consumer goods that are subject to a statute or treaty described in Section 9-311(a);

(2) an assignment of accounts or payment intangibles which does not by itself or in conjunction with other assignments to the same assignee transfer a significant part of the assignor's outstanding accounts or payment intangibles;

(3) a sale of a payment intangible;

(4) a sale of a promissory note;

(5) a security interest created by the assignment of a health-care-insurance receivable to the provider of the health-care goods or services;

(6) a security interest arising under Section 2-401, 2-505, 2-711(3), or 2A-508(5), until the debtor obtains possession of the collateral;

(7) a security interest of a collecting bank arising under Section 4-210;

(8) a security interest of an issuer or nominated person arising under Section 5-118;

(9) a security interest arising in the delivery of a financial asset under Section 9-206(c);

(10) a security interest in investment property created by a broker or securities intermediary;

(11) a security interest in a commodity contract or a commodity account created by a commodity intermediary;

(12) an assignment for the benefit of all creditors of the transferor and subsequent transfers by the assignee thereunder; and

(13) a security interest created by an assignment of a beneficial interest in a decedent's estate.

9-310. WHEN FILING REQUIRED TO PERFECT SECURITY INTEREST OR AGRICULTURAL LIEN; SECURITY INTERESTS AND AGRICULTURAL LIENS TO WHICH FILING PROVISIONS DO NOT APPLY.

(a) [General rule: perfection by filing.]

Except as otherwise provided in subsection (b) and Section 9-312(b), a financing statement must be filed to perfect all security interests and agricultural liens.

(b) [Exceptions: filing not necessary.]

The filing of a financing statement is not necessary to perfect a security interest:

(1) that is perfected under Section 9-308(d), (e), (f), or (g);

(2) that is perfected under Section 9-309 when it attaches;

(3) in property subject to a statute, regulation, or treaty described in Section 9-311(a);

(4) in goods in possession of a bailee which is perfected under Section 9-312(d)(1) or (2);

(5) in certificated securities, documents, goods, or instruments which is perfected without filing or possession under Section 9-312(e), (f), or (g);

(6) in collateral in the secured party's possession under Section 9-313;

(7) in a certificated security which is perfected by delivery of the security certificate to the secured party under Section 9-313;

(8) in deposit accounts, electronic chattel paper, investment property, or letter-of-credit rights which is perfected by control under Section 9-314;

(9) in proceeds which is perfected under Section 9-315; or

(10) that is perfected under Section 9-316.

(c) [Assignment of perfected security interest.]

If a secured party assigns a perfected security interest or agricultural lien, a filing under this article is not required to continue the perfected status of the security interest against creditors of and transferees from the original debtor.

9-311. PERFECTION OF SECURITY INTERESTS IN PROPERTY SUBJECT TO CERTAIN STATUTES, REGULATIONS, AND TREATIES.

(a) [Security interest subject to other law.]

Except as otherwise provided in subsection (d), the filing of a financing statement is not necessary or effective to perfect a security interest in property subject to:

(1) a statute, regulation, or treaty of the United States whose requirements for a security interest's obtaining priority over the rights of a lien creditor with respect to the property preempt Section 9-310(a);

(2) [list any certificate-of-title statute covering automobiles, trailers, mobile homes, boats, farm tractors, or the like, which provides for a security interest to be indicated on the certificate as a condition or result of perfection, and any non-Uniform Commercial Code central filing statute]; or

(3) a certificate-of-title statute of another jurisdiction which provides for a security interest to be indicated on the certificate as a condition or result of the security interest's obtaining priority over the rights of a lien creditor with respect to the property.

(b) [Compliance with other law.]

Compliance with the requirements of a statute, regulation, or treaty described in subsection (a) for obtaining priority over the rights of a lien creditor is equivalent to the filing of a financing statement under this article. Except as otherwise provided in subsection (d) and Sections 9-313 and 9-316(d) and (e) for goods covered by a certificate of title, a security interest in property subject to a statute, regulation, or treaty described in subsection (a) may be perfected only by compliance with those requirements, and a security interest so perfected remains perfected notwithstanding a change in the use or transfer of possession of the collateral.

(c) [Duration and renewal of perfection.]

Except as otherwise provided in subsection (d) and Section 9-316(d) and (e), duration and renewal of perfection of a security interest perfected by compliance with the requirements prescribed by a statute, regulation, or treaty described in subsection (a) are governed by the statute, regulation, or treaty. In other respects, the security interest is subject to this article.

(d) [Inapplicability to certain inventory.]

During any period in which collateral subject to a statute specified in subsection (a)(2) is inventory held for sale or lease by a person or leased by that person as lessor and that person is in the business of selling goods of that kind, this section does not apply to a security interest in that collateral created by that person.

9-312. PERFECTION OF SECURITY INTERESTS IN CHATTEL PAPER, DEPOSIT ACCOUNTS, DOCUMENTS, GOODS COVERED BY DOCUMENTS, INSTRUMENTS, INVESTMENT PROPERTY, LETTER-OF-CREDIT RIGHTS, AND MONEY; PERFECTION BY PERMISSIVE FILING; TEMPORARY PERFECTION WITHOUT FILING OR TRANSFER OF POSSESSION.

(a) [Perfection by filing permitted.]

A security interest in chattel paper, negotiable documents, instruments, or investment property may be perfected by filing.

(b) [Control or possession of certain collateral.]

Except as otherwise provided in Section 9-315(c) and (d) for proceeds:

(1) a security interest in a deposit account may be perfected only by control under Section 9-314;

(2) and except as otherwise provided in Section 9-308(d), a security interest in a letter-of-credit right may be perfected only by control under Section 9-314; and

(3) a security interest in money may be perfected only by the secured party's taking possession under Section 9-313.

(c) [Goods covered by negotiable document.]

While goods are in the possession of a bailee that has issued a negotiable document covering the goods:

(1) a security interest in the goods may be perfected by perfecting a security interest in the document; and

(2) a security interest perfected in the document has priority over any security interest that becomes perfected in the goods by another method during that time.

(d) [Goods covered by nonnegotiable document.]

While goods are in the possession of a bailee that has issued a nonnegotiable document covering the goods, a security interest in the goods may be perfected by:

(1) issuance of a document in the name of the secured party;

(2) the bailee's receipt of notification of the secured party's interest; or

(3) filing as to the goods.

(e) [Temporary perfection: new value.]

A security interest in certificated securities, negotiable documents, or instruments is perfected without filing or the taking of possession or control for a period of 20 days from the time it attaches to the extent that it arises for new value given under an authenticated security agreement.

(f) [Temporary perfection: goods or documents made available to debtor.]

A perfected security interest in a negotiable document or goods in possession of a bailee, other than one that has issued a negotiable document for the goods, remains perfected for 20 days without filing if the secured party makes available to the debtor the goods or documents representing the goods for the purpose of:

(1) ultimate sale or exchange; or

(2) loading, unloading, storing, shipping, transshipping, manufacturing, processing, or otherwise dealing with them in a manner preliminary to their sale or exchange.

(g) [Temporary perfection: delivery of security certificate or instrument to debtor.]

A perfected security interest in a certificated security or instrument remains perfected for 20 days without filing if the secured party delivers the security certificate or instrument to the debtor for the purpose of:

(1) ultimate sale or exchange; or

(2) presentation, collection, enforcement, renewal, or registration of transfer.

(h) [Expiration of temporary perfection.]

After the 20-day period specified in subsection (e), (f), or (g) expires, perfection depends upon compliance with this article.

9-313. WHEN POSSESSION BY OR DELIVERY TO SECURED PARTY PERFECTS SECURITY INTEREST WITHOUT FILING.

(a) [Perfection by possession or delivery.]

Except as otherwise provided in subsection (b), a secured party may perfect a security interest in negotiable documents, goods, instruments, money, or tangible chattel paper by taking possession of the collateral. A secured party may perfect a security interest in certificated securities by taking delivery of the certificated securities under Section 8-301.

(b) [Goods covered by certificate of title.]

With respect to goods covered by a certificate of title issued by this State, a secured party may perfect a security interest in the goods by taking possession of the goods only in the circumstances described in Section 9-316(d).

(c) [Collateral in possession of person other than debtor.]

With respect to collateral other than certificated securities and goods covered by a document, a secured party takes possession of collateral in the possession of a person other than the debtor, the secured party, or a lessee of the collateral from the debtor in the ordinary course of the debtor's business, when:

(1) the person in possession authenticates a record acknowledging that it holds possession of the collateral for the secured party's benefit; or

(2) the person takes possession of the collateral after having authenticated a record acknowledging that it will hold possession of collateral for the secured party's benefit.

(d) [Time of perfection by possession; continuation of perfection.]

If perfection of a security interest depends upon possession of the collateral by a secured party, perfection occurs no earlier than the time the secured party takes possession and continues only while the secured party retains possession.

(e) [Time of perfection by delivery; continuation of perfection.]

A security interest in a certificated security in registered form is perfected by delivery when delivery of the certificated security occurs under Section 8-301 and remains perfected by delivery until the debtor obtains possession of the security certificate.

(f) [Acknowledgment not required.]

A person in possession of collateral is not required to acknowledge that it holds possession for a secured party's benefit.

(g) [Effectiveness of acknowledgment; no duties or confirmation.]

If a person acknowledges that it holds possession for the secured party's benefit:

(1) the acknowledgment is effective under subsection (c) or Section 8-301(a), even if the acknowledgment violates the rights of a debtor; and

(2) unless the person otherwise agrees or law other than this article otherwise provides, the person does not owe any duty to the secured party and is not required to confirm the acknowledgment to another person.

(h) [Secured party's delivery to person other than debtor.]

A secured party having possession of collateral does not relinquish possession by delivering the collateral to a person other than the debtor or a lessee of the collateral from the debtor in the ordinary course of the debtor's business if the person was instructed before the delivery or is instructed contemporaneously with the delivery:

(1) to hold possession of the collateral for the secured party's benefit; or

(2) to redeliver the collateral to the secured party.

(i) [Effect of delivery under subsection (h); no duties or confirmation.]

A secured party does not relinquish possession, even if a delivery under subsection (h) violates the rights of a debtor. A person to which collateral is delivered under subsection (h) does not owe any duty to the secured party and is not required to confirm the delivery to another person unless the person otherwise agrees or law other than this article otherwise provides.

9-314. PERFECTION BY CONTROL.

(a) [Perfection by control.]

A security interest in investment property, deposit accounts, letter-of-credit rights, or electronic chattel paper may be perfected by control of the collateral under Section 9-104, 9-105, 9-106, or 9-107.

(b) [Specified collateral: time of perfection by control; continuation of perfection.]

A security interest in deposit accounts, electronic chattel paper, or letter-of-credit rights is perfected by control under Section 9-104, 9-105, or 9-107 when the secured party obtains control and remains perfected by control only while the secured party retains control.

(c) [Investment property: time of perfection by control; continuation of perfection.]

A security interest in investment property is perfected by control under Section 9-106 from the time the secured party obtains control and remains perfected by control until:

(1) the secured party does not have control; and

(2) one of the following occurs:

(A) if the collateral is a certificated security, the debtor has or acquires possession of the security certificate;

(B) if the collateral is an uncertificated security, the issuer has registered or registers the debtor as the registered owner; or

(C) if the collateral is a security entitlement, the debtor is or becomes the entitlement holder.

9-315. SECURED PARTY'S RIGHTS ON DISPOSITION OF COLLATERAL AND IN PROCEEDS.

(a) [Disposition of collateral: continuation of security interest or agricultural lien; proceeds.]

Except as otherwise provided in this article and in Section 2-403(2):

(1) a security interest or agricultural lien continues in collateral notwithstanding sale, lease, license, exchange, or other disposition thereof unless the secured party authorized the disposition free of the security interest or agricultural lien; and

(2) a security interest attaches to any identifiable proceeds of collateral.

(b) [When commingled proceeds identifiable.]

Proceeds that are commingled with other property are identifiable proceeds:

(1) if the proceeds are goods, to the extent provided by Section 9-336; and

(2) if the proceeds are not goods, to the extent that the secured party identifies the proceeds by a method of tracing, including application of equitable principles, that is permitted under law other than this article with respect to commingled property of the type involved.

(c) [Perfection of security interest in proceeds.]

A security interest in proceeds is a perfected security interest if the security interest in the original collateral was perfected.

(d) [Continuation of perfection.]

A perfected security interest in proceeds becomes unperfected on the 21st day after the security interest attaches to the proceeds unless:

(1) the following conditions are satisfied:

(A) a filed financing statement covers the original collateral;

(B) the proceeds are collateral in which a security interest may be perfected by filing in the office in which the financing statement has been filed; and

(C) the proceeds are not acquired with cash proceeds;

(2) the proceeds are identifiable cash proceeds; or

(3) the security interest in the proceeds is perfected other than under subsection (c) when the security interest attaches to the proceeds or within 20 days thereafter.

(e) [When perfected security interest in proceeds becomes unperfected.]

If a filed financing statement covers the original collateral, a security interest in proceeds which remains perfected under subsection (d)(1) becomes unperfected at the later of:

(1) when the effectiveness of the filed financing statement lapses under Section 9-515 or is terminated under Section 9-513; or

(2) the 21st day after the security interest attaches to the proceeds.

9-316. CONTINUED PERFECTION OF SECURITY INTEREST FOLLOWING CHANGE IN GOVERNING LAW.

(a) [General rule: effect on perfection of change in governing law.]

A security interest perfected pursuant to the law of the jurisdiction designated in Section 9-301(1) or 9-305(c) remains perfected until the earliest of:

(1) the time perfection would have ceased under the law of that jurisdiction;

(2) the expiration of four months after a change of the debtor's location to another jurisdiction; or

(3) the expiration of one year after a transfer of collateral to a person that thereby becomes a debtor and is located in another jurisdiction.

(b) [Security interest perfected or unperfected under law of new jurisdiction.]

If a security interest described in subsection (a) becomes perfected under the law of the other jurisdiction before the earliest time or event described in that subsection, it remains perfected thereafter. If the security interest does not become perfected under the law of the other jurisdiction before the earliest time or event, it becomes unperfected and is deemed never to have been perfected as against a purchaser of the collateral for value.

(c) [Possessory security interest in collateral moved to new jurisdiction.]

A possessory security interest in collateral, other than goods covered by a certificate of title and as-extracted collateral consisting of goods, remains continuously perfected if:

(1) the collateral is located in one jurisdiction and subject to a security interest perfected under the law of that jurisdiction;

(2) thereafter the collateral is brought into another jurisdiction; and

(3) upon entry into the other jurisdiction, the security interest is perfected under the law of the other jurisdiction.

(d) [Goods covered by certificate of title from this state.]

Except as otherwise provided in subsection (e), a security interest in goods covered by a certificate of title which is perfected by any method under the law of another jurisdiction when the goods become covered by a certificate of title from this State remains perfected until the security interest would have become unperfected under the law of the other jurisdiction had the goods not become so covered.

(e) [When subsection (d) security interest becomes unperfected against purchasers.]

A security interest described in subsection (d) becomes unperfected as against a purchaser of the goods for value and is deemed never to have been perfected as against a purchaser of the goods for value if the applicable requirements for perfection under Section 9-311(b) or 9-313 are not satisfied before the earlier of:

(1) the time the security interest would have become unperfected under the law of the other jurisdiction had the goods not become covered by a certificate of title from this State; or

(2) the expiration of four months after the goods had become so covered.

(f) [Change in jurisdiction of bank, issuer, nominated person, securities intermediary, or commodity intermediary.]

A security interest in deposit accounts, letter-of-credit rights, or investment property which is perfected under the law of the bank's jurisdiction, the issuer's jurisdiction, a nominated person's jurisdiction, the securities intermediary's jurisdiction, or the commodity intermediary's jurisdiction, as applicable, remains perfected until the earlier of:

(1) the time the security interest would have become unperfected under the law of that jurisdiction; or

(2) the expiration of four months after a change of the applicable jurisdiction to another jurisdiction.

(g) [Subsection (f) security interest perfected or unperfected under law of new jurisdiction.]

If a security interest described in subsection (f) becomes perfected under the law of the other jurisdiction before the earlier of the time or the end of the period described in that subsection, it remains perfected thereafter. If the security interest does not become perfected under the law of the other jurisdiction before the earlier of that time or the end of that period, it becomes unperfected and is deemed never to have been perfected as against a purchaser of the collateral for value.

[Subpart 3. Priority] [Table of Contents]

9-317. INTERESTS THAT TAKE PRIORITY OVER OR TAKE FREE OF SECURITY INTEREST OR AGRICULTURAL LIEN.

(a) [Conflicting security interests and rights of lien creditors.]

A security interest or agricultural lien is subordinate to the rights of:

(1) a person entitled to priority under Section 9-322; and

(2) except as otherwise provided in subsection (e), a person that becomes a lien creditor before the earlier of the time:

(A) the security interest or agricultural lien is perfected; or

(B) one of the conditions specified in Section 9-203(b)(3) is met and a financing statement covering the collateral is filed.

(b) [Buyers that receive delivery.]

Except as otherwise provided in subsection (e), a buyer, other than a secured party, of tangible chattel paper, documents, goods, instruments, or a security certificate takes free of a security interest or agricultural lien if the buyer gives value and receives delivery of the collateral without knowledge of the security interest or agricultural lien and before it is perfected.

(c) [Lessees that receive delivery.]

Except as otherwise provided in subsection (e), a lessee of goods takes free of a security interest or agricultural lien if the lessee gives value and receives delivery of the collateral without knowledge of the security interest or agricultural lien and before it is perfected.

(d) [Licensees and buyers of certain collateral.]

A licensee of a general intangible or a buyer, other than a secured party, of accounts, electronic chattel paper, general intangibles, or investment property other than a certificated security takes free

of a security interest if the licensee or buyer gives value without knowledge of the security interest and before it is perfected.

(e) [Purchase-money security interest.]

Except as otherwise provided in Sections 9-320 and 9-321, if a person files a financing statement with respect to a purchase-money security interest before or within 20 days after the debtor receives delivery of the collateral, the security interest takes priority over the rights of a buyer, lessee, or lien creditor which arise between the time the security interest attaches and the time of filing.

9-318. NO INTEREST RETAINED IN RIGHT TO PAYMENT THAT IS SOLD; RIGHTS AND TITLE OF SELLER OF ACCOUNT OR CHATTEL PAPER WITH RESPECT TO CREDITORS AND PURCHASERS.

(a) [Seller retains no interest.]

A debtor that has sold an account, chattel paper, payment intangible, or promissory note does not retain a legal or equitable interest in the collateral sold.

(b) [Deemed rights of debtor if buyer's security interest unperfected.]

For purposes of determining the rights of creditors of, and purchasers for value of an account or chattel paper from, a debtor that has sold an account or chattel paper, while the buyer's security interest is unperfected, the debtor is deemed to have rights and title to the account or chattel paper identical to those the debtor sold.

9-319. RIGHTS AND TITLE OF CONSIGNEE WITH RESPECT TO CREDITORS AND PURCHASERS.

(a) [Consignee has consignor's rights.]

Except as otherwise provided in subsection (b), for purposes of determining the rights of creditors of, and purchasers for value of goods from, a consignee, while the goods are in the possession of the consignee, the consignee is deemed to have rights and title to the goods identical to those the consignor had or had power to transfer.

(b) [Applicability of other law.]

For purposes of determining the rights of a creditor of a consignee, law other than this article determines the rights and title of a consignee while goods are in the consignee's possession if, under this part, a perfected security interest held by the consignor would have priority over the rights of the creditor.

9-320. BUYER OF GOODS.

(a) [Buyer in ordinary course of business.]

Except as otherwise provided in subsection (e), a buyer in ordinary course of business, other than a person buying farm products from a person engaged in farming operations, takes free of a security interest created by the buyer's seller, even if the security interest is perfected and the buyer knows of its existence.

(b) [Buyer of consumer goods.]

Except as otherwise provided in subsection (e), a buyer of goods from a person who used or bought the goods for use primarily for personal, family, or household purposes takes free of a security interest, even if perfected, if the buyer buys:

(1) without knowledge of the security interest;

(2) for value;

(3) primarily for the buyer's personal, family, or household purposes; and

(4) before the filing of a financing statement covering the goods.

(c) [Effectiveness of filing for subsection (b).]

To the extent that it affects the priority of a security interest over a buyer of goods under subsection (b), the period of effectiveness of a filing made in the jurisdiction in which the seller is located is governed by Section 9-316(a) and (b).

(d) [Buyer in ordinary course of business at wellhead or minehead.]

A buyer in ordinary course of business buying oil, gas, or other minerals at the wellhead or minehead or after extraction takes free of an interest arising out of an encumbrance.

(e) [Possessory security interest not affected.]

Subsections (a) and (b) do not affect a security interest in goods in the possession of the secured party under Section 9-313.

9-321. LICENSEE OF GENERAL INTANGIBLE AND LESSEE OF GOODS IN ORDINARY COURSE OF BUSINESS.

(a) ["Licensee in ordinary course of business."]

In this section, "licensee in ordinary course of business" means a person that becomes a licensee of a general intangible in good faith, without knowledge that the license violates the rights of another person in the general intangible, and in the ordinary course from a person in the business of licensing general intangibles of that kind. A person becomes a licensee in the ordinary course if the license to the person comports with the usual or customary practices in the kind of business in which the licensor is engaged or with the licensor's own usual or customary practices.

(b) [Rights of licensee in ordinary course of business.]

A licensee in ordinary course of business takes its rights under a nonexclusive license free of a security interest in the general intangible created by the licensor, even if the security interest is perfected and the licensee knows of its existence.

(c) [Rights of lessee in ordinary course of business.]

A lessee in ordinary course of business takes its leasehold interest free of a security interest in the goods created by the lessor, even if the security interest is perfected and the lessee knows of its existence.

9-322. PRIORITIES AMONG CONFLICTING SECURITY INTERESTS IN AND AGRICULTURAL LIENS ON SAME COLLATERAL.

(a) [General priority rules.]

Except as otherwise provided in this section, priority among conflicting security interests and agricultural liens in the same collateral is determined according to the following rules:

(1) Conflicting perfected security interests and agricultural liens rank according to priority in time of filing or perfection. Priority dates from the earlier of the time a filing covering the collateral is first made or the security interest or agricultural lien is first perfected, if there is no period thereafter when there is neither filing nor perfection.

(2) A perfected security interest or agricultural lien has priority over a conflicting unperfected security interest or agricultural lien.

(3) The first security interest or agricultural lien to attach or become effective has priority if conflicting security interests and agricultural liens are unperfected.

(b) [Time of perfection: proceeds and supporting obligations.]

For the purposes of subsection (a)(1):

(1) the time of filing or perfection as to a security interest in collateral is also the time of filing or perfection as to a security interest in proceeds; and

(2) the time of filing or perfection as to a security interest in collateral supported by a supporting obligation is also the time of filing or perfection as to a security interest in the supporting obligation.

(c) [Special priority rules: proceeds and supporting obligations.]

Except as otherwise provided in subsection (f), a security interest in collateral which qualifies for priority over a conflicting security interest under Section 9-327, 9-328, 9-329, 9-330, or 9-331 also has priority over a conflicting security interest in:

(1) any supporting obligation for the collateral; and

(2) proceeds of the collateral if:

(A) the security interest in proceeds is perfected;

(B) the proceeds are cash proceeds or of the same type as the collateral; and

(C) in the case of proceeds that are proceeds of proceeds, all intervening proceeds are cash proceeds, proceeds of the same type as the collateral, or an account relating to the collateral.

(d) [First-to-file priority rule for certain collateral.]

Subject to subsection (e) and except as otherwise provided in subsection (f), if a security interest in chattel paper, deposit accounts, negotiable documents, instruments, investment property, or letter-of-credit rights is perfected by a method other than filing, conflicting perfected security interests in proceeds of the collateral rank according to priority in time of filing.

(e) [Applicability of subsection (d).]

Subsection (d) applies only if the proceeds of the collateral are not cash proceeds, chattel paper, negotiable documents, instruments, investment property, or letter-of-credit rights.

(f) [Limitations on subsections (a) through (e).]

Subsections (a) through (e) are subject to:

(1) subsection (g) and the other provisions of this part;

(2) Section 4-210 with respect to a security interest of a collecting bank;

(3) Section 5-118 with respect to a security interest of an issuer or nominated person; and

(4) Section 9-110 with respect to a security interest arising under Article 2 or 2A.

(g) [Priority under agricultural lien statute.]

A perfected agricultural lien on collateral has priority over a conflicting security interest in or agricultural lien on the same collateral if the statute creating the agricultural lien so provides.

9-323. FUTURE ADVANCES.

(a) [When priority based on time of advance.]

Except as otherwise provided in subsection (c), for purposes of determining the priority of a perfected security interest under Section 9-322(a)(1), perfection of the security interest dates from the time an advance is made to the extent that the security interest secures an advance that:

(1) is made while the security interest is perfected only:

(A) under Section 9-309 when it attaches; or

(B) temporarily under Section 9-312(e), (f), or (g); and

(2) is not made pursuant to a commitment entered into before or while the security interest is perfected by a method other than under Section 9-309 or 9-312(e), (f), or (g).

(b) [Lien creditor.]

Except as otherwise provided in subsection (c), a security interest is subordinate to the rights of a person that becomes a lien creditor to the extent that the security interest secures an advance made more than 45 days after the person becomes a lien creditor unless the advance is made:

(1) without knowledge of the lien; or

(2) pursuant to a commitment entered into without knowledge of the lien.

(c) [Buyer of receivables.]

Subsections (a) and (b) do not apply to a security interest held by a secured party that is a buyer of accounts, chattel paper, payment intangibles, or promissory notes or a consignor.

(d) [Buyer of goods.]

Except as otherwise provided in subsection (e), a buyer of goods other than a buyer in ordinary course of business takes free of a security interest to the extent that it secures advances made after the earlier of:

(1) the time the secured party acquires knowledge of the buyer's purchase; or

(2) 45 days after the purchase.

(e) [Advances made pursuant to commitment: priority of buyer of goods.]

Subsection (d) does not apply if the advance is made pursuant to a commitment entered into without knowledge of the buyer's purchase and before the expiration of the 45-day period.

(f) [Lessee of goods.]

Except as otherwise provided in subsection (g), a lessee of goods, other than a lessee in ordinary course of business, takes the leasehold interest free of a security interest to the extent that it secures advances made after the earlier of:

(1) the time the secured party acquires knowledge of the lease; or

(2) 45 days after the lease contract becomes enforceable.

(g) [Advances made pursuant to commitment: priority of lessee of goods.]

Subsection (f) does not apply if the advance is made pursuant to a commitment entered into without knowledge of the lease and before the expiration of the 45-day period.

9-324. PRIORITY OF PURCHASE-MONEY SECURITY INTERESTS.

(a) [General rule: purchase-money priority.]

Except as otherwise provided in subsection (g), a perfected purchase-money security interest in goods other than inventory or livestock has priority over a conflicting security interest in the same goods, and, except as otherwise provided in Section 9-327, a perfected security interest in its identifiable proceeds also has priority, if the purchase-money security interest is perfected when the debtor receives possession of the collateral or within 20 days thereafter.

(b) [Inventory purchase-money priority.]

Subject to subsection (c) and except as otherwise provided in subsection (g), a perfected purchase-money security interest in inventory has priority over a conflicting security interest in the same inventory, has priority over a conflicting security interest in chattel paper or an instrument constituting proceeds of the inventory and in proceeds of the chattel paper, if so provided in Section 9-330, and, except as otherwise provided in Section 9-327, also has priority in identifiable cash proceeds of the inventory to the extent the identifiable cash proceeds are received on or before the delivery of the inventory to a buyer, if:

(1) the purchase-money security interest is perfected when the debtor receives possession of the inventory;

(2) the purchase-money secured party sends an authenticated notification to the holder of the conflicting security interest;

(3) the holder of the conflicting security interest receives the notification within five years before the debtor receives possession of the inventory; and

(4) the notification states that the person sending the notification has or expects to acquire a purchase-money security interest in inventory of the debtor and describes the inventory.

(c) [Holders of conflicting inventory security interests to be notified.]

Subsections (b)(2) through (4) apply only if the holder of the conflicting security interest had filed a financing statement covering the same types of inventory:

(1) if the purchase-money security interest is perfected by filing, before the date of the filing; or

(2) if the purchase-money security interest is temporarily perfected without filing or possession under Section 9-312(f), before the beginning of the 20-day period thereunder.

(d) [Livestock purchase-money priority.]

Subject to subsection (e) and except as otherwise provided in subsection (g), a perfected purchase-money security interest in livestock that are farm products has priority over a conflicting security interest in the same livestock, and, except as otherwise provided in Section 9-327, a perfected security interest in their identifiable proceeds and identifiable products in their unmanufactured states also has priority, if:

(1) the purchase-money security interest is perfected when the debtor receives possession of the livestock;

(2) the purchase-money secured party sends an authenticated notification to the holder of the conflicting security interest;

(3) the holder of the conflicting security interest receives the notification within six months before the debtor receives possession of the livestock; and

(4) the notification states that the person sending the notification has or expects to acquire a purchase-money security interest in livestock of the debtor and describes the livestock.

(e) [Holders of conflicting livestock security interests to be notified.]

Subsections (d)(2) through (4) apply only if the holder of the conflicting security interest had filed a financing statement covering the same types of livestock:

(1) if the purchase-money security interest is perfected by filing, before the date of the filing; or

(2) if the purchase-money security interest is temporarily perfected without filing or possession under Section 9-312(f), before the beginning of the 20-day period thereunder.

(f) [Software purchase-money priority.]

Except as otherwise provided in subsection (g), a perfected purchase-money security interest in software has priority over a conflicting security interest in the same collateral, and, except as otherwise provided in Section 9-327, a perfected security interest in its identifiable proceeds also has priority, to the extent that the purchase-money security interest in the goods in which the software was acquired for use has priority in the goods and proceeds of the goods under this section.

(g) [Conflicting purchase-money security interests.]

If more than one security interest qualifies for priority in the same collateral under subsection (a), (b), (d), or (f):

(1) a security interest securing an obligation incurred as all or part of the price of the collateral has priority over a security interest securing an obligation incurred for value given to enable the debtor to acquire rights in or the use of collateral; and

(2) in all other cases, Section 9-322(a) applies to the qualifying security interests.

9-325. PRIORITY OF SECURITY INTERESTS IN TRANSFERRED COLLATERAL.

(a) [Subordination of security interest in transferred collateral.]

Except as otherwise provided in subsection (b), a security interest created by a debtor is subordinate to a security interest in the same collateral created by another person if:

(1) the debtor acquired the collateral subject to the security interest created by the other person;

(2) the security interest created by the other person was perfected when the debtor acquired the collateral; and

(3) there is no period thereafter when the security interest is unperfected.

(b) [Limitation of subsection (a) subordination.]

Subsection (a) subordinates a security interest only if the security interest:

(1) otherwise would have priority solely under Section 9-322(a) or 9-324; or

(2) arose solely under Section 2-711(3) or 2A-508(5).

9-326. PRIORITY OF SECURITY INTERESTS CREATED BY NEW DEBTOR.

(a) [Subordination of security interest created by new debtor.]

Subject to subsection (b), a security interest created by a new debtor which is perfected by a filed financing statement that is effective solely under Section 9-508 in collateral in which a new debtor has or acquires rights is subordinate to a security interest in the same collateral which is perfected other than by a filed financing statement that is effective solely under Section 9-508.

(b) [Priority under other provisions; multiple original debtors.]

The other provisions of this part determine the priority among conflicting security interests in the same collateral perfected by filed financing statements that are effective solely under Section 9-508. However, if the security agreements to which a new debtor became bound as debtor were not entered into by the same original debtor, the conflicting security interests rank according to priority in time of the new debtor's having become bound.

9-327. PRIORITY OF SECURITY INTERESTS IN DEPOSIT ACCOUNT.

The following rules govern priority among conflicting security interests in the same deposit account:

(1) A security interest held by a secured party having control of the deposit account under Section 9-104 has priority over a conflicting security interest held by a secured party that does not have control.

(2) Except as otherwise provided in paragraphs (3) and (4), security interests perfected by control under Section 9-314 rank according to priority in time of obtaining control.

(3) Except as otherwise provided in paragraph (4), a security interest held by the bank with which the deposit account is maintained has priority over a conflicting security interest held by another secured party.

(4) A security interest perfected by control under Section 9-104(a)(3) has priority over a security interest held by the bank with which the deposit account is maintained.

9-328. PRIORITY OF SECURITY INTERESTS IN INVESTMENT PROPERTY.

The following rules govern priority among conflicting security interests in the same investment property:

(1) A security interest held by a secured party having control of investment property under Section 9-106 has priority over a security interest held by a secured party that does not have control of the investment property.

(2) Except as otherwise provided in paragraphs (3) and (4), conflicting security interests held by secured parties each of which has control under Section 9-106 rank according to priority in time of:

(A) if the collateral is a security, obtaining control;

(B) if the collateral is a security entitlement carried in a securities account and:

(i) if the secured party obtained control under Section 8-106(d)(1), the secured party's becoming the person for which the securities account is maintained;

(ii) if the secured party obtained control under Section 8-106(d)(2), the securities intermediary's agreement to comply with the secured party's entitlement orders with respect to security entitlements carried or to be carried in the securities account; or

(iii) if the secured party obtained control through another person under Section 8-106(d)(3), the time on which priority would be based under this paragraph if the other person were the secured party; or

(C) if the collateral is a commodity contract carried with a commodity intermediary, the satisfaction of the requirement for control specified in Section 9-106(b)(2) with respect to commodity contracts carried or to be carried with the commodity intermediary.

(3) A security interest held by a securities intermediary in a security entitlement or a securities account maintained with the securities intermediary has priority over a conflicting security interest held by another secured party.

(4) A security interest held by a commodity intermediary in a commodity contract or a commodity account maintained with the commodity intermediary has priority over a conflicting security interest held by another secured party.

(5) A security interest in a certificated security in registered form which is perfected by taking delivery under Section 9-313(a) and not by control under Section 9-314 has priority over a conflicting security interest perfected by a method other than control.

(6) Conflicting security interests created by a broker, securities intermediary, or commodity intermediary which are perfected without control under Section 9-106 rank equally.

(7) In all other cases, priority among conflicting security interests in investment property is governed by Sections 9-322 and 9-323.

9-329. PRIORITY OF SECURITY INTERESTS IN LETTER-OF-CREDIT RIGHT.

The following rules govern priority among conflicting security interests in the same letter-of-credit right:

(1) A security interest held by a secured party having control of the letter-of-credit right under Section 9-107 has priority to the extent of its control over a conflicting security interest held by a secured party that does not have control.

(2) Security interests perfected by control under Section 9-314 rank according to priority in time of obtaining control.

9-330. PRIORITY OF PURCHASER OF CHATTEL PAPER OR INSTRUMENT.

(a) [Purchaser's priority: security interest claimed merely as proceeds.]

A purchaser of chattel paper has priority over a security interest in the chattel paper which is claimed merely as proceeds of inventory subject to a security interest if:

(1) in good faith and in the ordinary course of the purchaser's business, the purchaser gives new value and takes possession of the chattel paper or obtains control of the chattel paper under Section 9-105; and

(2) the chattel paper does not indicate that it has been assigned to an identified assignee other than the purchaser.

(b) [Purchaser's priority: other security interests.]

A purchaser of chattel paper has priority over a security interest in the chattel paper which is claimed other than merely as proceeds of inventory subject to a security interest if the purchaser gives new

value and takes possession of the chattel paper or obtains control of the chattel paper under Section 9-105 in good faith, in the ordinary course of the purchaser's business, and without knowledge that the purchase violates the rights of the secured party.

(c) [Chattel paper purchaser's priority in proceeds.]

Except as otherwise provided in Section 9-327, a purchaser having priority in chattel paper under subsection (a) or (b) also has priority in proceeds of the chattel paper to the extent that:

(1) Section 9-322 provides for priority in the proceeds; or

(2) the proceeds consist of the specific goods covered by the chattel paper or cash proceeds of the specific goods, even if the purchaser's security interest in the proceeds is unperfected.

(d) [Instrument purchaser's priority.]

Except as otherwise provided in Section 9-331(a), a purchaser of an instrument has priority over a security interest in the instrument perfected by a method other than possession if the purchaser gives value and takes possession of the instrument in good faith and without knowledge that the purchase violates the rights of the secured party.

(e) [Holder of purchase-money security interest gives new value.]

For purposes of subsections (a) and (b), the holder of a purchase-money security interest in inventory gives new value for chattel paper constituting proceeds of the inventory.

(f) [Indication of assignment gives knowledge.]

For purposes of subsections (b) and (d), if chattel paper or an instrument indicates that it has been assigned to an identified secured party other than the purchaser, a purchaser of the chattel paper or instrument has knowledge that the purchase violates the rights of the secured party.

9-331. PRIORITY OF RIGHTS OF PURCHASERS OF INSTRUMENTS, DOCUMENTS, AND SECURITIES UNDER OTHER ARTICLES; PRIORITY OF INTERESTS IN FINANCIAL ASSETS AND SECURITY ENTITLEMENTS UNDER ARTICLE 8.

(a) [Rights under Articles 3, 7, and 8 not limited.]

This article does not limit the rights of a holder in due course of a negotiable instrument, a holder to which a negotiable document of title has been duly negotiated, or a protected purchaser of a security. These holders or purchasers take priority over an earlier security interest, even if perfected, to the extent provided in Articles 3, 7, and 8.

(b) [Protection under Article 8.]

This article does not limit the rights of or impose liability on a person to the extent that the person is protected against the assertion of a claim under Article 8.

(c) [Filing not notice.]

Filing under this article does not constitute notice of a claim or defense to the holders, or purchasers, or persons described in subsections (a) and (b).

9-332. TRANSFER OF MONEY; TRANSFER OF FUNDS FROM DEPOSIT ACCOUNT.

(a) [Transferee of money.]

A transferee of money takes the money free of a security interest unless the transferee acts in collusion with the debtor in violating the rights of the secured party.

(b) [Transferee of funds from deposit account.]

A transferee of funds from a deposit account takes the funds free of a security interest in the deposit account unless the transferee acts in collusion with the debtor in violating the rights of the secured party.

9-333. PRIORITY OF CERTAIN LIENS ARISING BY OPERATION OF LAW.

(a) ["Possessory lien."]

In this section, "possessory lien" means an interest, other than a security interest or an agricultural lien:

(1) which secures payment or performance of an obligation for services or materials furnished with respect to goods by a person in the ordinary course of the person's business;

(2) which is created by statute or rule of law in favor of the person; and

(3) whose effectiveness depends on the person's possession of the goods.

(b) [Priority of possessory lien.]

A possessory lien on goods has priority over a security interest in the goods unless the lien is created by a statute that expressly provides otherwise.

9-334. PRIORITY OF SECURITY INTERESTS IN FIXTURES AND CROPS.

(a) [Security interest in fixtures under this article.]

A security interest under this article may be created in goods that are fixtures or may continue in goods that become fixtures. A security interest does not exist under this article in ordinary building materials incorporated into an improvement on land.

(b) [Security interest in fixtures under real-property law.]

This article does not prevent creation of an encumbrance upon fixtures under real property law.

(c) [General rule: subordination of security interest in fixtures.]

In cases not governed by subsections (d) through (h), a security interest in fixtures is subordinate to a conflicting interest of an encumbrancer or owner of the related real property other than the debtor.

(d) [Fixtures purchase-money priority.]

Except as otherwise provided in subsection (h), a perfected security interest in fixtures has priority over a conflicting interest of an encumbrancer or owner of the real property if the debtor has an interest of record in or is in possession of the real property and:

(1) the security interest is a purchase-money security interest;

(2) the interest of the encumbrancer or owner arises before the goods become fixtures; and

(3) the security interest is perfected by a fixture filing before the goods become fixtures or within 20 days thereafter.

(e) [Priority of security interest in fixtures over interests in real property.]

A perfected security interest in fixtures has priority over a conflicting interest of an encumbrancer or owner of the real property if:

(1) the debtor has an interest of record in the real property or is in possession of the real property and the security interest:

(A) is perfected by a fixture filing before the interest of the encumbrancer or owner is of record; and

(B) has priority over any conflicting interest of a predecessor in title of the encumbrancer or owner;

(2) before the goods become fixtures, the security interest is perfected by any method permitted by this article and the fixtures are readily removable:

(A) factory or office machines;

(B) equipment that is not primarily used or leased for use in the operation of the real property; or

(C) replacements of domestic appliances that are consumer goods;

(3) the conflicting interest is a lien on the real property obtained by legal or equitable proceedings after the security interest was perfected by any method permitted by this article; or

(4) the security interest is:

(A) created in a manufactured home in a manufactured-home transaction; and

(B) perfected pursuant to a statute described in Section 9-311(a)(2).

(f) [Priority based on consent, disclaimer, or right to remove.]

A security interest in fixtures, whether or not perfected, has priority over a conflicting interest of an encumbrancer or owner of the real property if:

(1) the encumbrancer or owner has, in an authenticated record, consented to the security interest or disclaimed an interest in the goods as fixtures; or

(2) the debtor has a right to remove the goods as against the encumbrancer or owner.

(g) [Continuation of paragraph (f)(2) priority.]

The priority of the security interest under paragraph (f)(2) continues for a reasonable time if the debtor's right to remove the goods as against the encumbrancer or owner terminates.

(h) [Priority of construction mortgage.]

A mortgage is a construction mortgage to the extent that it secures an obligation incurred for the construction of an improvement on land, including the acquisition cost of the land, if a recorded record of the mortgage so indicates. Except as otherwise provided in subsections (e) and (f), a security interest in fixtures is subordinate to a construction mortgage if a record of the mortgage is recorded before the goods become fixtures and the goods become fixtures before the completion of the construction. A mortgage has this priority to the same extent as a construction mortgage to the extent that it is given to refinance a construction mortgage.

(i) [Priority of security interest in crops.]

A perfected security interest in crops growing on real property has priority over a conflicting interest of an encumbrancer or owner of the real property if the debtor has an interest of record in or is in possession of the real property.

(j) [Subsection (i) prevails.]

Subsection (i) prevails over any inconsistent provisions of the following statutes:

[List here any statutes containing provisions inconsistent with subsection (i).]

9-335. ACCESSIONS.

(a) [Creation of security interest in accession.]

A security interest may be created in an accession and continues in collateral that becomes an accession.

(b) [Perfection of security interest.]

If a security interest is perfected when the collateral becomes an accession, the security interest remains perfected in the collateral.

(c) [Priority of security interest.]

Except as otherwise provided in subsection (d), the other provisions of this part determine the priority of a security interest in an accession.

(d) [Compliance with certificate-of-title statute.]

A security interest in an accession is subordinate to a security interest in the whole which is perfected by compliance with the requirements of a certificate-of-title statute under Section 9-311(b).

(e) [Removal of accession after default.]

After default, subject to Part 6, a secured party may remove an accession from other goods if the security interest in the accession has priority over the claims of every person having an interest in the whole.

(f) [Reimbursement following removal.]

A secured party that removes an accession from other goods under subsection (e) shall promptly reimburse any holder of a security interest or other lien on, or owner of, the whole or of the other goods, other than the debtor, for the cost of repair of any physical injury to the whole or the other goods. The secured party need not reimburse the holder or owner for any diminution in value of the whole or the other goods caused by the absence of the accession removed or by any necessity for replacing it. A person entitled to reimbursement may refuse permission to remove until the secured party gives adequate assurance for the performance of the obligation to reimburse.

9-336. COMMINGLED GOODS.

(a) ["Commingled goods."]

In this section, "commingled goods" means goods that are physically united with other goods in such a manner that their identity is lost in a product or mass.

(b) [No security interest in commingled goods as such.]

A security interest does not exist in commingled goods as such. However, a security interest may attach to a product or mass that results when goods become commingled goods.

(c) [Attachment of security interest to product or mass.]

If collateral becomes commingled goods, a security interest attaches to the product or mass.

(d) [Perfection of security interest.]

If a security interest in collateral is perfected before the collateral becomes commingled goods, the security interest that attaches to the product or mass under subsection (c) is perfected.

(e) [Priority of security interest.]

Except as otherwise provided in subsection (f), the other provisions of this part determine the priority of a security interest that attaches to the product or mass under subsection (c).

(f) [Conflicting security interests in product or mass]

If more than one security interest attaches to the product or mass under subsection (c), the following rules determine priority:

(1) A security interest that is perfected under subsection (d) has priority over a security interest that is unperfected at the time the collateral becomes commingled goods.

(2) If more than one security interest is perfected under subsection (d), the security interests rank equally in proportion to the value of the collateral at the time it became commingled goods.

9-337. PRIORITY OF SECURITY INTERESTS IN GOODS COVERED BY CERTIFICATE OF TITLE.

If, while a security interest in goods is perfected by any method under the law of another jurisdiction, this State issues a certificate of title that does not show that the goods are subject to the security interest or contain a statement that they may be subject to security interests not shown on the certificate:

(1) a buyer of the goods, other than a person in the business of selling goods of that kind, takes free of the security interest if the buyer gives value and receives delivery of the goods after issuance of the certificate and without knowledge of the security interest; and

(2) the security interest is subordinate to a conflicting security interest in the goods that attaches, and is perfected under Section 9-311(b), after issuance of the certificate and without the conflicting secured party's knowledge of the security interest.

9-338. PRIORITY OF SECURITY INTEREST OR AGRICULTURAL LIEN PERFECTED BY FILED FINANCING STATEMENT PROVIDING CERTAIN INCORRECT INFORMATION.

If a security interest or agricultural lien is perfected by a filed financing statement providing information described in Section 9-516(b)(5) which is incorrect at the time the financing statement is filed:

(1) the security interest or agricultural lien is subordinate to a conflicting perfected security interest in the collateral to the extent that the holder of the conflicting security interest gives value in reasonable reliance upon the incorrect information; and

(2) a purchaser, other than a secured party, of the collateral takes free of the security interest or agricultural lien to the extent that, in reasonable reliance upon the incorrect information, the purchaser gives value and, in the case of chattel paper, documents, goods, instruments, or a security certificate, receives delivery of the collateral.

9-339. PRIORITY SUBJECT TO SUBORDINATION.

This article does not preclude subordination by agreement by a person entitled to priority.

[Subpart 4. Rights of Bank] [Table of Contents]

9-340. EFFECTIVENESS OF RIGHT OF RECOUPMENT OR SET-OFF AGAINST DEPOSIT ACCOUNT.

(a) [Exercise of recoupment or set-off.]

Except as otherwise provided in subsection (c), a bank with which a deposit account is maintained may exercise any right of recoupment or set-off against a secured party that holds a security interest in the deposit account.

(b) [Recoupment or setoff not affected by security interest.]

Except as otherwise provided in subsection (c), the application of this article to a security interest in a deposit account does not affect a right of recoupment or set-off of the secured party as to a deposit account maintained with the secured party.

(c) [When set-off ineffective.]

The exercise by a bank of a set-off against a deposit account is ineffective against a secured party that holds a security interest in the deposit account which is perfected by control under Section 9-104(a)(3), if the set-off is based on a claim against the debtor.

9-341. BANK'S RIGHTS AND DUTIES WITH RESPECT TO DEPOSIT ACCOUNT.

Except as otherwise provided in Section 9-340(c), and unless the bank otherwise agrees in an authenticated record, a bank's rights and duties with respect to a deposit account maintained with the bank are not terminated, suspended, or modified by:

(1) the creation, attachment, or perfection of a security interest in the deposit account;

(2) the bank's knowledge of the security interest; or

(3) the bank's receipt of instructions from the secured party.

9-342. BANK'S RIGHT TO REFUSE TO ENTER INTO OR DISCLOSE EXISTENCE OF CONTROL AGREEMENT.

This article does not require a bank to enter into an agreement of the kind described in Section 9-104(a)(2), even if its customer so requests or directs. A bank that has entered into such an agreement is not required to confirm the existence of the agreement to another person unless requested to do so by its customer.

Part 4. Rights of Third Parties [Table of Contents]

9-401. ALIENABILITY OF DEBTOR'S RIGHTS.

(a) [Other law governs alienability; exceptions.]

Except as otherwise provided in subsection (b) and Sections 9-406, 9-407, 9-408, and 9-409, whether a debtor's rights in collateral may be voluntarily or involuntarily transferred is governed by law other than this article.

(b) [Agreement does not prevent transfer.]

An agreement between the debtor and secured party which prohibits a transfer of the debtor's rights in collateral or makes the transfer a default does not prevent the transfer from taking effect.

9-402. SECURED PARTY NOT OBLIGATED ON CONTRACT OF DEBTOR OR IN TORT.

The existence of a security interest, agricultural lien, or authority given to a debtor to dispose of or use collateral, without more, does not subject a secured party to liability in contract or tort for the debtor's acts or omissions.

9-403. AGREEMENT NOT TO ASSERT DEFENSES AGAINST ASSIGNEE.

(a) ["Value."]

In this section, "value" has the meaning provided in Section 3-303(a).

(b) [Agreement not to assert claim or defense.]

Except as otherwise provided in this section, an agreement between an account debtor and an assignor not to assert against an assignee any claim or defense that the account debtor may have against the assignor is enforceable by an assignee that takes an assignment:

(1) for value;

(2) in good faith;

(3) without notice of a claim of a property or possessory right to the property assigned; and

(4) without notice of a defense or claim in recoupment of the type that may be asserted against a person entitled to enforce a negotiable instrument under Section 3-305(a).

(c) [When subsection (b) not applicable.]

Subsection (b) does not apply to defenses of a type that may be asserted against a holder in due course of a negotiable instrument under Section 3-305(b).

(d) [Omission of required statement in consumer transaction.]

In a consumer transaction, if a record evidences the account debtor's obligation, law other than this article requires that the record include a statement to the effect that the rights of an assignee are subject to claims or defenses that the account debtor could assert against the original obligee, and the record does not include such a statement:

(1) the record has the same effect as if the record included such a statement; and

(2) the account debtor may assert against an assignee those claims and defenses that would have been available if the record included such a statement.

(e) [Rule for individual under other law.]

This section is subject to law other than this article which establishes a different rule for an account debtor who is an individual and who incurred the obligation primarily for personal, family, or household purposes.

(f) [Other law not displaced.]

Except as otherwise provided in subsection (d), this section does not displace law other than this article which gives effect to an agreement by an account debtor not to assert a claim or defense against an assignee.

9-404. RIGHTS ACQUIRED BY ASSIGNEE; CLAIMS AND DEFENSES AGAINST ASSIGNEE.

(a) [Assignee's rights subject to terms, claims, and defenses; exceptions.]

Unless an account debtor has made an enforceable agreement not to assert defenses or claims, and subject to subsections (b) through (e), the rights of an assignee are subject to:

(1) all terms of the agreement between the account debtor and assignor and any defense or claim in recoupment arising from the transaction that gave rise to the contract; and

(2) any other defense or claim of the account debtor against the assignor which accrues before the account debtor receives a notification of the assignment authenticated by the assignor or the assignee.

(b) [Account debtor's claim reduces amount owed to assignee.]

Subject to subsection (c) and except as otherwise provided in subsection (d), the claim of an account debtor against an assignor may be asserted against an assignee under subsection (a) only to reduce the amount the account debtor owes.

(c) [Rule for individual under other law.]

This section is subject to law other than this article which establishes a different rule for an account debtor who is an individual and who incurred the obligation primarily for personal, family, or household purposes.

(d) [Omission of required statement in consumer transaction.]

In a consumer transaction, if a record evidences the account debtor's obligation, law other than this article requires that the record include a statement to the effect that the account debtor's recovery against an assignee with respect to claims and defenses against the assignor may not exceed amounts paid by the account debtor under the record, and the record does not include such a statement, the extent to which a claim of an account debtor against the assignor may be asserted against an assignee is determined as if the record included such a statement.

(e) [Inapplicability to health-care-insurance receivable.]

This section does not apply to an assignment of a health-care-insurance receivable.

9-405. MODIFICATION OF ASSIGNED CONTRACT.

(a) [Effect of modification on assignee.]

A modification of or substitution for an assigned contract is effective against an assignee if made in good faith. The assignee acquires corresponding rights under the modified or substituted contract. The assignment may provide that the modification or substitution is a breach of contract by the assignor. This subsection is subject to subsections (b) through (d).

(b) [Applicability of subsection (a).]

Subsection (a) applies to the extent that:

(1) the right to payment or a part thereof under an assigned contract has not been fully earned by performance; or

(2) the right to payment or a part thereof has been fully earned by performance and the account debtor has not received notification of the assignment under Section 9-406(a).

(c) [Rule for individual under other law.]

This section is subject to law other than this article which establishes a different rule for an account debtor who is an individual and who incurred the obligation primarily for personal, family, or household purposes.

(d) [Inapplicability to health-care-insurance receivable.]

This section does not apply to an assignment of a health-care-insurance receivable.

9-406. DISCHARGE OF ACCOUNT DEBTOR; NOTIFICATION OF ASSIGNMENT; IDENTIFICATION AND PROOF OF ASSIGNMENT; RESTRICTIONS ON ASSIGNMENT OF ACCOUNTS, CHATTEL PAPER, PAYMENT INTANGIBLES, AND PROMISSORY NOTES INEFFECTIVE.

(a) [Discharge of account debtor; effect of notification.]

Subject to subsections (b) through (i), an account debtor on an account, chattel paper, or a payment intangible may discharge its obligation by paying the assignor until, but not after, the account debtor receives a notification, authenticated by the assignor or the assignee, that the amount due or to become due has been assigned and that payment is to be made to the assignee. After receipt of the notification, the account debtor may discharge its obligation by paying the assignee and may not discharge the obligation by paying the assignor.

(b) [When notification ineffective.]

Subject to subsection (h), notification is ineffective under subsection (a):

(1) if it does not reasonably identify the rights assigned;

(2) to the extent that an agreement between an account debtor and a seller of a payment intangible limits the account debtor's duty to pay a person other than the seller and the limitation is effective under law other than this article; or

(3) at the option of an account debtor, if the notification notifies the account debtor to make less than the full amount of any installment or other periodic payment to the assignee, even if:

(A) only a portion of the account, chattel paper, or payment intangible has been assigned to that assignee;

(B) a portion has been assigned to another assignee; or

(C) the account debtor knows that the assignment to that assignee is limited.

(c) [Proof of assignment.]

Subject to subsection (h), if requested by the account debtor, an assignee shall seasonably furnish reasonable proof that the assignment has been made. Unless the assignee complies, the account debtor may discharge its obligation by paying the assignor, even if the account debtor has received a notification under subsection (a).

(d) [Term restricting assignment generally ineffective.]

Except as otherwise provided in subsection (e) and Sections 2A-303 and 9-407, and subject to subsection (h), a term in an agreement between an account debtor and an assignor or in a promissory note is ineffective to the extent that it:

(1) prohibits, restricts, or requires the consent of the account debtor or person obligated on the promissory note to the assignment or transfer of, or the creation, attachment, perfection, or enforcement of a security interest in, the account, chattel paper, payment intangible, or promissory note; or

(2) provides that the assignment or transfer or the creation, attachment, perfection, or enforcement of the security interest may give rise to a default, breach, right of recoupment, claim, defense, termination, right of termination, or remedy under the account, chattel paper, payment intangible, or promissory note.

(e) [Inapplicability of subsection (d) to certain sales.]

Subsection (d) does not apply to the sale of a payment intangible or promissory note.

(f) [Legal restrictions on assignment generally ineffective.]

Except as otherwise provided in Sections 2A-303 and 9-407 and subject to subsections (h)and (i), a rule of law, statute, or regulation that prohibits, restricts, or requires the consent of a government, governmental body or official, or account debtor to the assignment or transfer of, or creation of a security interest in, an account or chattel paper is ineffective to the extent that the rule of law, statute, or regulation:

(1) prohibits, restricts, or requires the consent of the government, governmental body or official, or account debtor to the assignment or transfer of, or the creation, attachment, perfection, or enforcement of a security interest in the account or chattel paper; or

(2) provides that the creation, attachment, perfection, or enforcement of the security interest may give rise to a default, breach, right of recoupment, claim, defense, termination, right of termination, or remedy under the account or chattel paper.

(g) [Subsection (b)(3) not waivable.]

Subject to subsection (h), an account debtor may not waive or vary its option under subsection (b)(3).

(h) [Rule for individual under other law.]

This section is subject to law other than this article which establishes a different rule for an account debtor who is an individual and who incurred the obligation primarily for personal, family, or household purposes.

(i) [Inapplicability to health-care-insurance receivable.]

This section does not apply to an assignment of a health-care-insurance receivable.

(j) [Section prevails over specified inconsistent law.]

This section prevails over any inconsistent provisions of the following statutes, rules, and regulations:

[List here any statutes, rules, and regulations containing provisions inconsistent with this section.]

9-407. RESTRICTIONS ON CREATION OR ENFORCEMENT OF SECURITY INTEREST IN LEASEHOLD INTEREST OR IN LESSOR'S RESIDUAL INTEREST.

(a) [Term restricting assignment generally ineffective.]

Except as otherwise provided in subsection (b), a term in a lease agreement is ineffective to the extent that it:

(1) prohibits, restricts, or requires the consent of a party to the lease to the the assignment or transfer of, or the creation, attachment, perfection, or enforcement of a security interest in an interest of a party under the lease contract or in the lessor's residual interest in the goods; or

(2) provides that the assignment or transfer or the creation, attachment, perfection, or enforcement of the security interest may give rise to a default, breach, right of recoupment, claim, defense, termination, right of termination, or remedy under the lease.

(b) [Effectiveness of certain terms.]

Except as otherwise provided in Section 2A-303(7), a term described in subsection (a)(2) is effective to the extent that there is:

(1) a transfer by the lessee of the lessee's right of possession or use of the goods in violation of the term; or

(2) a delegation of a material performance of either party to the lease contract in violation of the term.

(c) [Security interest not material impairment.]

The creation, attachment, perfection, or enforcement of a security interest in the lessor's interest under the lease contract or the lessor's residual interest in the goods is not a transfer that materially impairs the lessee's prospect of obtaining return performance or materially changes the duty of or materially increases the burden or risk imposed on the lessee within the purview of Section 2A-303(4) unless, and then only to the extent that, enforcement actually results in a delegation of material performance of the lessor.

9-408. RESTRICTIONS ON ASSIGNMENT OF PROMISSORY NOTES, HEALTH-CARE-INSURANCE RECEIVABLES, AND CERTAIN GENERAL INTANGIBLES INEFFECTIVE.

(a) [Term restricting assignment generally ineffective.]

Except as otherwise provided in subsection (b), a term in a promissory note or in an agreement between an account debtor and a debtor which relates to a health-care-insurance receivable or a general intangible, including a contract, permit, license, or franchise, and which term prohibits, restricts, or requires the consent of the person obligated on the promissory note or the account debtor to, the assignment or transfer of, or creation, attachment, or perfection of a security interest

in, the promissory note, health-care-insurance receivable, or general intangible, is ineffective to the extent that the term:

(1) would impair the creation, attachment, or perfection of a security interest; or

(2) provides that the assignment or transfer or the creation, attachment, or perfection of the security interest may give rise to a default, breach, right of recoupment, claim, defense, termination, right of termination, or remedy under the promissory note, health-care-insurance receivable, or general intangible.

(b) [Applicability of subsection (a) to sales of certain rights to payment.]

Subsection (a) applies to a security interest in a payment intangible or promissory note only if the security interest arises out of a sale of the payment intangible or promissory note.

(c) [Legal restrictions on assignment generally ineffective.]

A rule of law, statute, or regulation that prohibits, restricts, or requires the consent of a government, governmental body or official, person obligated on a promissory note, or account debtor to the assignment or transfer of, or creation of a security interest in, a promissory note, health-care-insurance receivable, or general intangible, including a contract, permit, license, or franchise between an account debtor and a debtor, is ineffective to the extent that the rule of law, statute, or regulation:

(1) would impair the creation, attachment, or perfection of a security interest; or

(2) provides that the the assignment or transfer or creation, attachment, or perfection of the security interest may give rise to a default, breach, right of recoupment, claim, defense, termination, right of termination, or remedy under the promissory note, health-care-insurance receivable, or general intangible.

(d) [Limitation on ineffectiveness under subsections (a) and (c).]

To the extent that a term in a promissory note or in an agreement between an account debtor and a debtor which relates to a health-care-insurance receivable or general intangible or a rule of law, statute, or regulation described in subsection (c) would be effective under law other than this article but is ineffective under subsection (a) or (c), the creation, attachment, or perfection of a security interest in the promissory note, health-care-insurance receivable, or general intangible:

(1) is not enforceable against the person obligated on the promissory note or the account debtor;

(2) does not impose a duty or obligation on the person obligated on the promissory note or the account debtor;

(3) does not require the person obligated on the promissory note or the account debtor to recognize the security interest, pay or render performance to the secured party, or accept payment or performance from the secured party;

(4) does not entitle the secured party to use or assign the debtor's rights under the promissory note, health-care-insurance receivable, or general intangible, including any related information or materials furnished to the debtor in the transaction giving rise to the promissory note, health-care-insurance receivable, or general intangible;

(5) does not entitle the secured party to use, assign, possess, or have access to any trade secrets or confidential information of the person obligated on the promissory note or the account debtor; and

(6) does not entitle the secured party to enforce the security interest in the promissory note, health-care-insurance receivable, or general intangible.

(e) [Section prevails over specified inconsistent law.]

This section prevails over any inconsistent provisions of the following statutes, rules, and regulations:

[List here any statutes, rules, and regulations containing provisions inconsistent with this section.]

9-409. RESTRICTIONS ON ASSIGNMENT OF LETTER-OF-CREDIT RIGHTS INEFFECTIVE.

(a) [Term or law restricting assignment generally ineffective.]

A term in a letter of credit or a rule of law, statute, regulation, custom, or practice applicable to the letter of credit which prohibits, restricts, or requires the consent of an applicant, issuer, or nominated person to a beneficiary's assignment of or creation of a security interest in a letter-of-credit right is ineffective to the extent that the term or rule of law, statute, regulation, custom, or practice:

(1) would impair the creation, attachment, or perfection of a security interest in the letter-of-credit right; or

(2) provides that the creation, attachment, or perfection of the security interest may give rise to a default, breach, right of recoupment, claim, defense, termination, right of termination, or remedy under the letter-of-credit right.

(b) [Limitation on ineffectiveness under subsection (a).]

To the extent that a term in a letter of credit is ineffective under subsection (a) but would be effective under law other than this article or a custom or practice applicable to the letter of credit, to the transfer of a right to draw or otherwise demand performance under the letter of credit, or to the assignment of a right to proceeds of the letter of credit, the creation, attachment, or perfection of a security interest in the letter-of-credit right:

(1) is not enforceable against the applicant, issuer, nominated person, or transferee beneficiary;

(2) imposes no duties or obligations on the applicant, issuer, nominated person, or transferee beneficiary; and

(3) does not require the applicant, issuer, nominated person, or transferee beneficiary to recognize the security interest, pay or render performance to the secured party, or accept payment or other performance from the secured party.

Part 5. Filing [Table of Contents]

[Subpart 1. Filing Office; Contents and Effectiveness of Financing Statement] [Table of Contents]

9-501. FILING OFFICE.

(a) [Filing offices.]

Except as otherwise provided in subsection (b), if the local law of this State governs perfection of a security interest or agricultural lien, the office in which to file a financing statement to perfect the security interest or agricultural lien is:

(1) the office designated for the filing or recording of a record of a mortgage on the related real property, if:

(A) the collateral is as-extracted collateral or timber to be cut; or

(B) the financing statement is filed as a fixture filing and the collateral is goods that are or are to become fixtures; or

(2) the office of [or any office duly authorized by [ ]], in all other cases, including a case in which the collateral is goods that are or are to become fixtures and the financing statement is not filed as a fixture filing.

(b) [Filing office for transmitting utilities.]

The office in which to file a financing statement to perfect a security interest in collateral, including fixtures, of a transmitting utility is the office of [ ]. The financing statement also constitutes a fixture filing as to the collateral indicated in the financing statement which is or is to become fixtures.

9-502. CONTENTS OF FINANCING STATEMENT; RECORD OF MORTGAGE AS FINANCING STATEMENT; TIME OF FILING FINANCING STATEMENT.

(a) [Sufficiency of financing statement.]

Subject to subsection (b), a financing statement is sufficient only if it:

(1) provides the name of the debtor;

(2) provides the name of the secured party or a representative of the secured party; and

(3) indicates the collateral covered by the financing statement.

(b) [Real-property-related financing statements.]

Except as otherwise provided in Section 9-501(b), to be sufficient, a financing statement that covers as-extracted collateral or timber to be cut, or which is filed as a fixture filing and covers goods that are or are to become fixtures, must satisfy subsection (a) and also:

(1) indicate that it covers this type of collateral;

(2) indicate that it is to be filed [for record] in the real property records;

(3) provide a description of the real property to which the collateral is related [sufficient to give constructive notice of a mortgage under the law of this State if the description were contained in a record of the mortgage of the real property]; and

(4) if the debtor does not have an interest of record in the real property, provide the name of a record owner.

(c) [Record of mortgage as financing statement.]

A record of a mortgage is effective, from the date of recording, as a financing statement filed as a fixture filing or as a financing statement covering as-extracted collateral or timber to be cut only if:

(1) the record indicates the goods or accounts that it covers;

(2) the goods are or are to become fixtures related to the real property described in the record or the collateral is related to the real property described in the record and is as-extracted collateral or timber to be cut;

(3) the record satisfies the requirements for a financing statement in this section other than an indication that it is to be filed in the real property records; and

(4) the record is [duly] recorded.

(d) [Filing before security agreement or attachment.]

A financing statement may be filed before a security agreement is made or a security interest otherwise attaches.

9-503. NAME OF DEBTOR AND SECURED PARTY.

(a) [Sufficiency of debtor's name.]

A financing statement sufficiently provides the name of the debtor:

(1) if the debtor is a registered organization, only if the financing statement provides the name of the debtor indicated on the public record of the debtor's jurisdiction of organization which shows the debtor to have been organized;

(2) if the debtor is a decedent's estate, only if the financing statement provides the name of the decedent and indicates that the debtor is an estate;

(3) if the debtor is a trust or a trustee acting with respect to property held in trust, only if the financing statement:

(A) provides the name specified for the trust in its organic documents or, if no name is specified, provides the name of the settlor and additional information sufficient to distinguish the debtor from other trusts having one or more of the same settlors; and

(B) indicates, in the debtor's name or otherwise, that the debtor is a trust or is a trustee acting with respect to property held in trust; and

(4) in other cases:

(A) if the debtor has a name, only if it provides the individual or organizational name of the debtor; and

(B) if the debtor does not have a name, only if it provides the names of the partners, members, associates, or other persons comprising the debtor.

(b) [Additional debtor-related information.]

A financing statement that provides the name of the debtor in accordance with subsection (a) is not rendered ineffective by the absence of:

(1) a trade name or other name of the debtor; or

(2) unless required under subsection (a)(4)(B), names of partners, members, associates, or other persons comprising the debtor.

(c) [Debtor's trade name insufficient.]

A financing statement that provides only the debtor's trade name does not sufficiently provide the name of the debtor.

(d) [Representative capacity.]

Failure to indicate the representative capacity of a secured party or representative of a secured party does not affect the sufficiency of a financing statement.

(e) [Multiple debtors and secured parties.]

A financing statement may provide the name of more than one debtor and the name of more than one secured party.

9-504. INDICATION OF COLLATERAL.

A financing statement sufficiently indicates the collateral that it covers if the financing statement provides:

(1) a description of the collateral pursuant to Section 9-108; or

(2) an indication that the financing statement covers all assets or all personal property.

9-505. FILING AND COMPLIANCE WITH OTHER STATUTES AND TREATIES FOR CONSIGNMENTS, LEASES, OTHER BAILMENTS, AND OTHER TRANSACTIONS.

(a) [Use of terms other than "debtor" and "secured party."]

A consignor, lessor, or other bailor of goods, a licensor, or a buyer of a payment intangible or promissory note may file a financing statement, or may comply with a statute or treaty described in Section 9-311(a), using the terms "consignor", "consignee", "lessor", "lessee", "bailor", "bailee", "licensor", "licensee", "owner", "registered owner", "buyer", "seller", or words of similar import, instead of the terms "secured party" and "debtor".

(b) [Effect of financing statement under subsection (a).]

This part applies to the filing of a financing statement under subsection (a) and, as appropriate, to compliance that is equivalent to filing a financing statement under Section 9-311(b), but the filing or compliance is not of itself a factor in determining whether the collateral secures an obligation. If it is determined for another reason that the collateral secures an obligation, a security interest held by the consignor, lessor, bailor, licensor, owner, or buyer which attaches to the collateral is perfected by the filing or compliance.

9-506. EFFECT OF ERRORS OR OMISSIONS.

(a) [Minor errors and omissions.]

A financing statement substantially satisfying the requirements of this part is effective, even if it has minor errors or omissions, unless the errors or omissions make the financing statement seriously misleading.

(b) [Financing statement seriously misleading.]

Except as otherwise provided in subsection (c), a financing statement that fails sufficiently to provide the name of the debtor in accordance with Section 9-503(a) is seriously misleading.

(c) [Financing statement not seriously misleading.]

If a search of the records of the filing office under the debtor's correct name, using the filing office's standard search logic, if any, would disclose a financing statement that fails sufficiently to provide the name of the debtor in accordance with Section 9-503(a), the name provided does not make the financing statement seriously misleading.

(d) ["Debtor's correct name."]

For purposes of Section 9-508(b), the "debtor's correct name" in subsection (c) means the correct name of the new debtor.

9-507. EFFECT OF CERTAIN EVENTS ON EFFECTIVENESS OF FINANCING STATEMENT.

(a) [Disposition.]

A filed financing statement remains effective with respect to collateral that is sold, exchanged, leased, licensed, or otherwise disposed of and in which a security interest or agricultural lien continues, even if the secured party knows of or consents to the disposition.

(b) [Information becoming seriously misleading.]

Except as otherwise provided in subsection (c) and Section 9-508, a financing statement is not rendered ineffective if, after the financing statement is filed, the information provided in the financing statement becomes seriously misleading under Section 9-506.

(c) [Change in debtor's name.]

If a debtor so changes its name that a filed financing statement becomes seriously misleading under Section 9-506:

(1) the financing statement is effective to perfect a security interest in collateral acquired by the debtor before, or within four months after, the change; and

(2) the financing statement is not effective to perfect a security interest in collateral acquired by the debtor more than four months after the change, unless an amendment to the financing statement which renders the financing statement not seriously misleading is filed within four months after the change.

9-508. EFFECTIVENESS OF FINANCING STATEMENT IF NEW DEBTOR BECOMES BOUND BY SECURITY AGREEMENT.

(a) [Financing statement naming original debtor.]

Except as otherwise provided in this section, a filed financing statement naming an original debtor is effective to perfect a security interest in collateral in which a new debtor has or acquires rights to the extent that the financing statement would have been effective had the original debtor acquired rights in the collateral.

(b) [Financing statement becoming seriously misleading.]

If the difference between the name of the original debtor and that of the new debtor causes a filed financing statement that is effective under subsection (a) to be seriously misleading under Section 9-506:

(1) the financing statement is effective to perfect a security interest in collateral acquired by the new debtor before, and within four months after, the new debtor becomes bound under Section 9-203(d); and

(2) the financing statement is not effective to perfect a security interest in collateral acquired by the new debtor more than four months after the new debtor becomes bound under Section 9-203(d) unless an initial financing statement providing the name of the new debtor is filed before the expiration of that time.

(c) [When section not applicable.]

This section does not apply to collateral as to which a filed financing statement remains effective against the new debtor under Section 9-507(a).

9-509. PERSONS ENTITLED TO FILE A RECORD.

(a) [Person entitled to file record.]

A person may file an initial financing statement, amendment that adds collateral covered by a financing statement, or amendment that adds a debtor to a financing statement only if:

(1) the debtor authorizes the filing in an authenticated record or pursuant to subsection (b) or (c); or

(2) the person holds an agricultural lien that has become effective at the time of filing and the financing statement covers only collateral in which the person holds an agricultural lien.

(b) [Security agreement as authorization.]

By authenticating or becoming bound as debtor by a security agreement, a debtor or new debtor authorizes the filing of an initial financing statement, and an amendment, covering:

(1) the collateral described in the security agreement; and

(2) property that becomes collateral under Section 9-315(a)(2), whether or not the security agreement expressly covers proceeds.

(c) [Acquisition of collateral as authorization.]

By acquiring collateral in which a security interest or agricultural lien continues under Section 9-315(a)(1), a debtor authorizes the filing of an initial financing statement, and an amendment, covering the collateral and property that becomes collateral under Section 9-315(a)(2).

(d) [Person entitled to file certain amendments.]

A person may file an amendment other than an amendment that adds collateral covered by a financing statement or an amendment that adds a debtor to a financing statement only if:

(1) the secured party of record authorizes the filing; or

(2) the amendment is a termination statement for a financing statement as to which the secured party of record has failed to file or send a termination statement as required by Section 9-513(a)

or (c), the debtor authorizes the filing, and the termination statement indicates that the debtor authorized it to be filed.

(e) [Multiple secured parties of record.]

If there is more than one secured party of record for a financing statement, each secured party of record may authorize the filing of an amendment under subsection (d).

9-510. EFFECTIVENESS OF FILED RECORD.

(a) [Filed record effective if authorized.]

A filed record is effective only to the extent that it was filed by a person that may file it under Section 9-509.

(b) [Authorization by one secured party of record.]

A record authorized by one secured party of record does not affect the financing statement with respect to another secured party of record.

(c) [Continuation statement not timely filed.]

A continuation statement that is not filed within the six-month period prescribed by Section 9-515(d) is ineffective.

9-511. SECURED PARTY OF RECORD.

(a) [Secured party of record.]

A secured party of record with respect to a financing statement is a person whose name is provided as the name of the secured party or a representative of the secured party in an initial financing statement that has been filed. If an initial financing statement is filed under Section 9-514(a), the assignee named in the initial financing statement is the secured party of record with respect to the financing statement.

(b) [Amendment naming secured party of record.]

If an amendment of a financing statement which provides the name of a person as a secured party or a representative of a secured party is filed, the person named in the amendment is a secured party of record. If an amendment is filed under Section 9-514(b), the assignee named in the amendment is a secured party of record.

(c) [Amendment deleting secured party of record.]

A person remains a secured party of record until the filing of an amendment of the financing statement which deletes the person.

9-512. AMENDMENT OF FINANCING STATEMENT.

[Alternative A]

(a) [Amendment of information in financing statement.]

Subject to Section 9-509, a person may add or delete collateral covered by, continue or terminate the effectiveness of, or, subject to subsection (e), otherwise amend the information provided in, a financing statement by filing an amendment that:

(1) identifies, by its file number, the initial financing statement to which the amendment relates; and

(2) if the amendment relates to an initial financing statement filed [or recorded] in a filing office described in Section 9-501(a)(1), provides the information specified in Section 9-502(b).

[Alternative B]

(a) [Amendment of information in financing statement.]

Subject to Section 9-509, a person may add or delete collateral covered by, continue or terminate the effectiveness of, or, subject to subsection (e), otherwise amend the information provided in, a financing statement by filing an amendment that:

(1) identifies, by its file number, the initial financing statement to which the amendment relates; and

(2) if the amendment relates to an initial financing statement filed [or recorded] in a filing office described in Section 9-501(a)(1), provides the date [and time] that the initial financing statement was filed [or recorded] and the information specified in Section 9-502(b).

[End of Alternatives]

(b) [Period of effectiveness not affected.]

Except as otherwise provided in Section 9-515, the filing of an amendment does not extend the period of effectiveness of the financing statement.

(c) [Effectiveness of amendment adding collateral.]

A financing statement that is amended by an amendment that adds collateral is effective as to the added collateral only from the date of the filing of the amendment.

(d) [Effectiveness of amendment adding debtor.]

A financing statement that is amended by an amendment that adds a debtor is effective as to the added debtor only from the date of the filing of the amendment.

(e) [Certain amendments ineffective.]

An amendment is ineffective to the extent it:

(1) purports to delete all debtors and fails to provide the name of a debtor to be covered by the financing statement; or

(2) purports to delete all secured parties of record and fails to provide the name of a new secured party of record.

9-513. TERMINATION STATEMENT.

(a) [Consumer goods.]

A secured party shall cause the secured party of record for a financing statement to file a termination statement for the financing statement if the financing statement covers consumer goods and:

(1) there is no obligation secured by the collateral covered by the financing statement and no commitment to make an advance, incur an obligation, or otherwise give value; or

(2) the debtor did not authorize the filing of the initial financing statement.

(b) [Time for compliance with subsection (a).]

To comply with subsection (a), a secured party shall cause the secured party of record to file the termination statement:

(1) within one month after there is no obligation secured by the collateral covered by the financing statement and no commitment to make an advance, incur an obligation, or otherwise give value; or

(2) if earlier, within 20 days after the secured party receives an authenticated demand from a debtor.

(c) [Other collateral.]

In cases not governed by subsection (a), within 20 days after a secured party receives an authenticated demand from a debtor, the secured party shall cause the secured party of record for a financing statement to send to the debtor a termination statement for the financing statement or file the termination statement in the filing office if:

(1) except in the case of a financing statement covering accounts or chattel paper that has been sold or goods that are the subject of a consignment, there is no obligation secured by the collateral covered by the financing statement and no commitment to make an advance, incur an obligation, or otherwise give value;

(2) the financing statement covers accounts or chattel paper that has been sold but as to which the account debtor or other person obligated has discharged its obligation;

(3) the financing statement covers goods that were the subject of a consignment to the debtor but are not in the debtor's possession; or

(4) the debtor did not authorize the filing of the initial financing statement.

(d) [Effect of filing termination statement.]

Except as otherwise provided in Section 9-510, upon the filing of a termination statement with the filing office, the financing statement to which the termination statement relates ceases to be effective. Except as otherwise provided in Section 9-510, for purposes of Sections 9-519(g), 9-522(a), and 9-523(c), the filing with the filing office of a termination statement relating to a financing statement that

indicates that the debtor is a transmitting utility also causes the effectiveness of the financing statement to lapse.

9-514. ASSIGNMENT OF POWERS OF SECURED PARTY OF RECORD.

(a) [Assignment reflected on initial financing statement.]

Except as otherwise provided in subsection (c), an initial financing statement may reflect an assignment of all of the secured party's power to authorize an amendment to the financing statement by providing the name and mailing address of the assignee as the name and address of the secured party.

(b) [Assignment of filed financing statement.]

Except as otherwise provided in subsection (c), a secured party of record may assign of record all or part of its power to authorize an amendment to a financing statement by filing in the filing office an amendment of the financing statement which:

(1) identifies, by its file number, the initial financing statement to which it relates;

(2) provides the name of the assignor; and

(3) provides the name and mailing address of the assignee.

(c) [Assignment of record of mortgage.]

An assignment of record of a security interest in a fixture covered by a record of a mortgage which is effective as a financing statement filed as a fixture filing under Section 9-502(c) may be made only by an assignment of record of the mortgage in the manner provided by law of this State other than [the Uniform Commercial Code].

9-515. DURATION AND EFFECTIVENESS OF FINANCING STATEMENT; EFFECT OF LAPSED FINANCING STATEMENT.

(a) [Five-year effectiveness.]

Except as otherwise provided in subsections (b), (e), (f), and (g), a filed financing statement is effective for a period of five years after the date of filing.

(b) [Public-finance or manufactured-home transaction.]

Except as otherwise provided in subsections (e), (f), and (g), an initial financing statement filed in connection with a public-finance transaction or manufactured-home transaction is effective for a period of 30 years after the date of filing if it indicates that it is filed in connection with a public-finance transaction or manufactured-home transaction.

(c) [Lapse and continuation of financing statement.]

The effectiveness of a filed financing statement lapses on the expiration of the period of its effectiveness unless before the lapse a continuation statement is filed pursuant to subsection (d). Upon lapse, a financing statement ceases to be effective and any security interest or agricultural lien that was perfected by the financing statement becomes unperfected, unless the security interest is perfected otherwise. If the security interest or agricultural lien becomes unperfected upon lapse, it is deemed never to have been perfected as against a purchaser of the collateral for value.

(d) [When continuation statement may be filed.]

A continuation statement may be filed only within six months before the expiration of the five-year period specified in subsection (a) or the 30-year period specified in subsection (b), whichever is applicable.

(e) [Effect of filing continuation statement.]

Except as otherwise provided in Section 9-510, upon timely filing of a continuation statement, the effectiveness of the initial financing statement continues for a period of five years commencing on the day on which the financing statement would have become ineffective in the absence of the filing. Upon the expiration of the five-year period, the financing statement lapses in the same manner as provided in subsection (c), unless, before the lapse, another continuation statement is filed pursuant to subsection (d). Succeeding continuation statements may be filed in the same manner to continue the effectiveness of the initial financing statement.

(f) [Transmitting utility financing statement.]

If a debtor is a transmitting utility and a filed financing statement so indicates, the financing statement is effective until a termination statement is filed.

(g) [Record of mortgage as financing statement.]

A record of a mortgage that is effective as a financing statement filed as a fixture filing under Section 9-502(c) remains effective as a financing statement filed as a fixture filing until the mortgage is released or satisfied of record or its effectiveness otherwise terminates as to the real property.

9-516. WHAT CONSTITUTES FILING; EFFECTIVENESS OF FILING.

(a) [What constitutes filing.]

Except as otherwise provided in subsection (b), communication of a record to a filing office and tender of the filing fee or acceptance of the record by the filing office constitutes filing.

(b) [Refusal to accept record; filing does not occur.]

Filing does not occur with respect to a record that a filing office refuses to accept because:

(1) the record is not communicated by a method or medium of communication authorized by the filing office;

(2) an amount equal to or greater than the applicable filing fee is not tendered;

(3) the filing office is unable to index the record because:

(A) in the case of an initial financing statement, the record does not provide a name for the debtor;

(B) in the case of an amendment or correction statement, the record:

(i) does not identify the initial financing statement as required by Section 9-512 or 9-518, as applicable; or

(ii) identifies an initial financing statement whose effectiveness has lapsed under Section 9-515;

(C) in the case of an initial financing statement that provides the name of a debtor identified as an individual or an amendment that provides a name of a debtor identified as an individual which was not previously provided in the financing statement to which the record relates, the record does not identify the debtor's last name; or

(D) in the case of a record filed [or recorded] in the filing office described in Section 9-501(a)(1), the record does not provide a sufficient description of the real property to which it relates;

(4) in the case of an initial financing statement or an amendment that adds a secured party of record, the record does not provide a name and mailing address for the secured party of record;

(5) in the case of an initial financing statement or an amendment that provides a name of a debtor which was not previously provided in the financing statement to which the amendment relates, the record does not:

(A) provide a mailing address for the debtor;

(B) indicate whether the debtor is an individual or an organization; or

(C) if the financing statement indicates that the debtor is an organization, provide:

(i) a type of organization for the debtor;

(ii) a jurisdiction of organization for the debtor; or

(iii) an organizational identification number for the debtor or indicate that the debtor has none;

(6) in the case of an assignment reflected in an initial financing statement under Section 9-514(a) or an amendment filed under Section 9-514(b), the record does not provide a name and mailing address for the assignee; or

(7) in the case of a continuation statement, the record is not filed within the six-month period prescribed by Section 9-515(d).

(c) [Rules applicable to subsection (b).]

For purposes of subsection (b):

(1) a record does not provide information if the filing office is unable to read or decipher the information; and

(2) a record that does not indicate that it is an amendment or identify an initial financing statement to which it relates, as required by Section 9-512, 9-514, or 9-518, is an initial financing statement.

(d) [Refusal to accept record; record effective as filed record.]

A record that is communicated to the filing office with tender of the filing fee, but which the filing office refuses to accept for a reason other than one set forth in subsection (b), is effective as a filed record except as against a purchaser of the collateral which gives value in reasonable reliance upon the absence of the record from the files.

9-517. EFFECT OF INDEXING ERRORS.

The failure of the filing office to index a record correctly does not affect the effectiveness of the filed record.

9-518. CLAIM CONCERNING INACCURATE OR WRONGFULLY FILED RECORD.

(a) [Correction statement.]

A person may file in the filing office a correction statement with respect to a record indexed there under the person's name if the person believes that the record is inaccurate or was wrongfully filed.

[Alternative A]

(b) [Sufficiency of correction statement.]

A correction statement must:

(1) identify the record to which it relates by the file number assigned to the initial financing statement to which the record relates;

(2) indicate that it is a correction statement; and

(3) provide the basis for the person's belief that the record is inaccurate and indicate the manner in which the person believes the record should be amended to cure any inaccuracy or provide the basis for the person's belief that the record was wrongfully filed.

[Alternative B]

(b) [Sufficiency of correction statement.]

A correction statement must:

(1) identify the record to which it relates by:

(A) the file number assigned to the initial financing statement to which the record relates; and

(B) if the correction statement relates to a record filed [or recorded] in a filing office described in Section 9-501(a)(1), the date [and time] that the initial financing statement was filed [or recorded] and the information specified in Section 9-502(b);

(2) indicate that it is a correction statement; and

(3) provide the basis for the person's belief that the record is inaccurate and indicate the manner in which the person believes the record should be amended to cure any inaccuracy or provide the basis for the person's belief that the record was wrongfully filed.

[End of Alternatives]

(c) [Record not affected by correction statement.]

The filing of a correction statement does not affect the effectiveness of an initial financing statement or other filed record.

[Subpart 2. Duties and Operation of Filing Office] [Table of Contents]

9-519. NUMBERING, MAINTAINING, AND INDEXING RECORDS; COMMUNICATING INFORMATION PROVIDED IN RECORDS.

(a) [Filing office duties.]

For each record filed in a filing office, the filing office shall:

(1) assign a unique number to the filed record;

(2) create a record that bears the number assigned to the filed record and the date and time of filing;

(3) maintain the filed record for public inspection; and

(4) index the filed record in accordance with subsections (c), (d), and (e).

(b) [File number.]

A file number [assigned after January 1, 2002,] must include a digit that:

(1) is mathematically derived from or related to the other digits of the file number; and

(2) aids the filing office in determining whether a number communicated as the file number includes a single-digit or transpositional error.

(c) [Indexing: general.]

Except as otherwise provided in subsections (d) and (e), the filing office shall:

(1) index an initial financing statement according to the name of the debtor and index all filed records relating to the initial financing statement in a manner that associates with one another an initial financing statement and all filed records relating to the initial financing statement; and

(2) index a record that provides a name of a debtor which was not previously provided in the financing statement to which the record relates also according to the name that was not previously provided.

(d) [Indexing: real-property-related financing statement.]

If a financing statement is filed as a fixture filing or covers as-extracted collateral or timber to be cut, [it must be filed for record and] the filing office shall index it:

(1) under the names of the debtor and of each owner of record shown on the financing statement as if they were the mortgagors under a mortgage of the real property described; and

(2) to the extent that the law of this State provides for indexing of records of mortgages under the name of the mortgagee, under the name of the secured party as if the secured party were the mortgagee thereunder, or, if indexing is by description, as if the financing statement were a record of a mortgage of the real property described.

(e) [Indexing: real-property-related assignment.]

If a financing statement is filed as a fixture filing or covers as-extracted collateral or timber to be cut, the filing office shall index an assignment filed under Section 9-514(a) or an amendment filed under Section 9-514(b):

(1) under the name of the assignor as grantor; and

(2) to the extent that the law of this State provides for indexing a record of the assignment of a mortgage under the name of the assignee, under the name of the assignee.

[Alternative A]

(f) [Retrieval and association capability.]

The filing office shall maintain a capability:

(1) to retrieve a record by the name of the debtor and by the file number assigned to the initial financing statement to which the record relates; and

(2) to associate and retrieve with one another an initial financing statement and each filed record relating to the initial financing statement.

[Alternative B]

(f) [Retrieval and association capability.]

The filing office shall maintain a capability:

(1) to retrieve a record by the name of the debtor and:

(A) if the filing office is described in Section 9-501(a)(1), by the file number assigned to the initial financing statement to which the record relates and the date [and time] that the record was filed [or recorded]; or

(B) if the filing office is described in Section 9-501(a)(2), by the file number assigned to the initial financing statement to which the record relates; and

(2) to associate and retrieve with one another an initial financing statement and each filed record relating to the initial financing statement.

[End of Alternatives]

(g) [Removal of debtor's name.]

The filing office may not remove a debtor's name from the index until one year after the effectiveness of a financing statement naming the debtor lapses under Section 9-515 with respect to all secured parties of record.

(h) [Timeliness of filing office performance.]

The filing office shall perform the acts required by subsections (a) through (e) at the time and in the manner prescribed by filing-office rule, but not later than two business days after the filing office receives the record in question.

[(i) [Inapplicability to real-property-related filing office.]

[Subsections] [(b)] [and] [(h)] do[es] not apply to a filing office described in Section 9-501(a)(1).]

9-520. ACCEPTANCE AND REFUSAL TO ACCEPT RECORD.

(a) [Mandatory refusal to accept record.]

A filing office shall refuse to accept a record for filing for a reason set forth in Section 9-516(b) and may refuse to accept a record for filing only for a reason set forth in Section 9-516(b).

(b) [Communication concerning refusal.]

If a filing office refuses to accept a record for filing, it shall communicate to the person that presented the record the fact of and reason for the refusal and the date and time the record would have been filed had the filing office accepted it. The communication must be made at the time and in the manner prescribed by filing-office rule but [, in the case of a filing office described in Section 9-501(a)(2),] in no event more than two business days after the filing office receives the record.

(c) [When filed financing statement effective.]

A filed financing statement satisfying Section 9-502(a) and (b) is effective, even if the filing office is required to refuse to accept it for filing under subsection (a). However, Section 9-338 applies to a filed financing statement providing information described in Section 9-516(b)(5) which is incorrect at the time the financing statement is filed.

(d) [Separate application to multiple debtors.]

If a record communicated to a filing office provides information that relates to more than one debtor, this part applies as to each debtor separately.

9-521. UNIFORM FORM OF WRITTEN FINANCING STATEMENT AND AMENDMENT.

(a) [Initial financing statement form.]

A filing office that accepts written records may not refuse to accept a written initial financing statement in the following form and format except for a reason set forth in Section 9-516(b):

(b) [Amendment form.]

A filing office that accepts written records may not refuse to accept a written record in the following form and format except for a reason set forth in Section 9-516(b):

9-522. MAINTENANCE AND DESTRUCTION OF RECORDS.

[Alternative A]

(a) [Post-lapse maintenance and retrieval of information.]

The filing office shall maintain a record of the information provided in a filed financing statement for at least one year after the effectiveness of the financing statement has lapsed under Section 9-515 with respect to all secured parties of record. The record must be retrievable by using the name of the debtor and by using the file number assigned to the initial financing statement to which the record relates.

[Alternative B]

(a) [Post-lapse maintenance and retrieval of information.]

The filing office shall maintain a record of the information provided in a filed financing statement for at least one year after the effectiveness of the financing statement has lapsed under Section 9-515 with respect to all secured parties of record. The record must be retrievable by using the name of the debtor and:

(1) if the record was filed [or recorded] in the filing office described in Section 9-501(a)(1), by using the file number assigned to the initial financing statement to which the record relates and the date [and time] that the record was filed [or recorded]; or

(2) if the record was filed in the filing office described in Section 9-501(a)(2), by using the file number assigned to the initial financing statement to which the record relates.

[End of Alternatives]

(b) [Destruction of written records.]

Except to the extent that a statute governing disposition of public records provides otherwise, the filing office immediately may destroy any written record evidencing a financing statement. However, if the filing office destroys a written record, it shall maintain another record of the financing statement which complies with subsection (a).

9-523. INFORMATION FROM FILING OFFICE; SALE OR LICENSE OF RECORDS.

(a) [Acknowledgment of filing written record.]

If a person that files a written record requests an acknowledgment of the filing, the filing office shall send to the person an image of the record showing the number assigned to the record pursuant to Section 9-519(a)(1) and the date and time of the filing of the record. However, if the person furnishes a copy of the record to the filing office, the filing office may instead:

(1) note upon the copy the number assigned to the record pursuant to Section 9-519(a)(1) and the date and time of the filing of the record; and

(2) send the copy to the person.

(b) [Acknowledgment of filing other record.]

If a person files a record other than a written record, the filing office shall communicate to the person an acknowledgment that provides:

(1) the information in the record;

(2) the number assigned to the record pursuant to Section 9-519(a)(1); and

(3) the date and time of the filing of the record.

(c) [Communication of requested information.]

The filing office shall communicate or otherwise make available in a record the following information to any person that requests it:

(1) whether there is on file on a date and time specified by the filing office, but not a date earlier than three business days before the filing office receives the request, any financing statement that:

(A) designates a particular debtor [or, if the request so states, designates a particular debtor at the address specified in the request];

(B) has not lapsed under Section 9-515 with respect to all secured parties of record; and

(C) if the request so states, has lapsed under Section 9-515 and a record of which is maintained by the filing office under Section 9-522(a);

(2) the date and time of filing of each financing statement; and

(3) the information provided in each financing statement.

(d) [Medium for communicating information.]

In complying with its duty under subsection (c), the filing office may communicate information in any medium. However, if requested, the filing office shall communicate information by issuing [its written certificate] [a record that can be admitted into evidence in the courts of this State without extrinsic evidence of its authenticity].

(e) [Timeliness of filing office performance.]

The filing office shall perform the acts required by subsections (a) through (d) at the time and in the manner prescribed by filing-office rule, but not later than two business days after the filing office receives the request.

(f) [Public availability of records.]

At least weekly, the [insert appropriate official or governmental agency] [filing office] shall offer to sell or license to the public on a nonexclusive basis, in bulk, copies of all records filed in it under this part, in every medium from time to time available to the filing office.

9-524. DELAY BY FILING OFFICE.

Delay by the filing office beyond a time limit prescribed by this part is excused if:

(1) the delay is caused by interruption of communication or computer facilities, war, emergency conditions, failure of equipment, or other circumstances beyond control of the filing office; and

(2) the filing office exercises reasonable diligence under the circumstances.

9-525. FEES.

(a) [Initial financing statement or other record: general rule.]

Except as otherwise provided in subsection (e), the fee for filing and indexing a record under this part, other than an initial financing statement of the kind described in subsection (b), is [the amount specified in subsection (c), if applicable, plus]:

(1) $ __[X]_____ if the record is communicated in writing and consists of one or two pages;

(2) $ __[2X]_____if the record is communicated in writing and consists of more than two pages; and

(3) $ __[1/2X]___ if the record is communicated by another medium authorized by filing-office rule.

(b) [Initial financing statement: public-finance and manufactured-housing transactions.]

Except as otherwise provided in subsection (e), the fee for filing and indexing an initial financing statement of the following kind is [the amount specified in subsection (c), if applicable, plus]:

(1) $ _____if the financing statement indicates that it is filed in connection with a public-finance transaction;

(2) $ _____if the financing statement indicates that it is filed in connection with a manufactured-home transaction.

[Alternative A]

(c) [Number of names.]

The number of names required to be indexed does not affect the amount of the fee in subsections (a) and (b).

[Alternative B]

(c) [Number of names.]

Except as otherwise provided in subsection (e), if a record is communicated in writing, the fee for each name more than two required to be indexed is $ _____.

[End of Alternatives]

(d) [Response to information request.]

The fee for responding to a request for information from the filing office, including for [issuing a certificate showing] [communicating] whether there is on file any financing statement naming a particular debtor, is:

(1) $ ____ if the request is communicated in writing; and

(2) $ ____ if the request is communicated by another medium authorized by filing-office rule.

(e) [Record of mortgage.]

This section does not require a fee with respect to a record of a mortgage which is effective as a financing statement filed as a fixture filing or as a financing statement covering as-extracted collateral or timber to be cut under Section 9-502(c). However, the recording and satisfaction fees that otherwise would be applicable to the record of the mortgage apply.

9-526. FILING-OFFICE RULES.

(a) [Adoption of filing-office rules.]

The [insert appropriate governmental official or agency] shall adopt and publish rules to implement this article. The filing-office rules must be[:

(1)] consistent with this article[; and

(2) adopted and published in accordance with the [insert any applicable state administrative procedure act]].

(b) [Harmonization of rules.]

To keep the filing-office rules and practices of the filing office in harmony with the rules and practices of filing offices in other jurisdictions that enact substantially this part, and to keep the technology used by the filing office compatible with the technology used by filing offices in other jurisdictions that

enact substantially this part, the [insert appropriate governmental official or agency], so far as is consistent with the purposes, policies, and provisions of this article, in adopting, amending, and repealing filing-office rules, shall:

(1) consult with filing offices in other jurisdictions that enact substantially this part; and

(2) consult the most recent version of the Model Rules promulgated by the International Association of Corporate Administrators or any successor organization; and

(3) take into consideration the rules and practices of, and the technology used by, filing offices in other jurisdictions that enact substantially this part.

9-527. DUTY TO REPORT.

The [insert appropriate governmental official or agency] shall report [annually on or before _____] to the [Governor and Legislature] on the operation of the filing office. The report must contain a statement of the extent to which:

(1) the filing-office rules are not in harmony with the rules of filing offices in other jurisdictions that enact substantially this part and the reasons for these variations; and

(2) the filing-office rules are not in harmony with the most recent version of the Model Rules promulgated by the International Association of Corporate Administrators, or any successor organization, and the reasons for these variations.

Part 6. Default [Table of Contents]

[Subpart 1. Default and Enforcement of Security Interest] [Table of Contents]

9-601. RIGHTS AFTER DEFAULT; JUDICIAL ENFORCEMENT; CONSIGNOR OR BUYER OF ACCOUNTS, CHATTEL PAPER, PAYMENT INTANGIBLES, OR PROMISSORY NOTES.

(a) [Rights of secured party after default.]

After default, a secured party has the rights provided in this part and, except as otherwise provided in Section 9-602, those provided by agreement of the parties. A secured party:

(1) may reduce a claim to judgment, foreclose, or otherwise enforce the claim, security interest, or agricultural lien by any available judicial procedure; and

(2) if the collateral is documents, may proceed either as to the documents or as to the goods they cover.

(b) [Rights and duties of secured party in possession or control.]

A secured party in possession of collateral or control of collateral under Section 9-104, 9-105, 9-106, or 9-107 has the rights and duties provided in Section 9-207.

(c) [Rights cumulative; simultaneous exercise.]

The rights under subsections (a) and (b) are cumulative and may be exercised simultaneously.

(d) [Rights of debtor and obligor.]

Except as otherwise provided in subsection (g) and Section 9-605, after default, a debtor and an obligor have the rights provided in this part and by agreement of the parties.

(e) [Lien of levy after judgment.]

If a secured party has reduced its claim to judgment, the lien of any levy that may be made upon the collateral by virtue of an execution based upon the judgment relates back to the earliest of:

(1) the date of perfection of the security interest or agricultural lien in the collateral;

(2) the date of filing a financing statement covering the collateral; or

(3) any date specified in a statute under which the agricultural lien was created.

(f) [Execution sale.]

A sale pursuant to an execution is a foreclosure of the security interest or agricultural lien by judicial procedure within the meaning of this section. A secured party may purchase at the sale and thereafter hold the collateral free of any other requirements of this article.

(g) [Consignor or buyer of certain rights to payment.]

Except as otherwise provided in Section 9-607(c), this part imposes no duties upon a secured party that is a consignor or is a buyer of accounts, chattel paper, payment intangibles, or promissory notes.

9-602. WAIVER AND VARIANCE OF RIGHTS AND DUTIES.

Except as otherwise provided in Section 9-624, to the extent that they give rights to a debtor or obligor and impose duties on a secured party, the debtor or obligor may not waive or vary the rules stated in the following listed sections:

(1) Section 9-207(b)(4)(C), which deals with use and operation of the collateral by the secured party;

(2) Section 9-210, which deals with requests for an accounting and requests concerning a list of collateral and statement of account;

(3) Section 9-607(c), which deals with collection and enforcement of collateral;

(4) Sections 9-608(a) and 9-615(c) to the extent that they deal with application or payment of noncash proceeds of collection, enforcement, or disposition;

(5) Sections 9-608(a) and 9-615(d) to the extent that they require accounting for or payment of surplus proceeds of collateral;

(6) Section 9-609 to the extent that it imposes upon a secured party that takes possession of collateral without judicial process the duty to do so without breach of the peace;

(7) Sections 9-610(b), 9-611, 9-613, and 9-614, which deal with disposition of collateral;

(8) Section 9-615(f), which deals with calculation of a deficiency or surplus when a disposition is made to the secured party, a person related to the secured party, or a secondary obligor;

(9) Section 9-616, which deals with explanation of the calculation of a surplus or deficiency;

(10) Sections 9-620, 9-621, and 9-622, which deal with acceptance of collateral in satisfaction of obligation;

(11) Section 9-623, which deals with redemption of collateral;

(12) Section 9-624, which deals with permissible waivers; and

(13) Sections 9-625 and 9-626, which deal with the secured party's liability for failure to comply with this article.

9-603. AGREEMENT ON STANDARDS CONCERNING RIGHTS AND DUTIES.

(a) [Agreed standards.]

The parties may determine by agreement the standards measuring the fulfillment of the rights of a debtor or obligor and the duties of a secured party under a rule stated in Section 9-602 if the standards are not manifestly unreasonable.

(b) [Agreed standards inapplicable to breach of peace.]

Subsection (a) does not apply to the duty under Section 9-609 to refrain from breaching the peace.

9-604. PROCEDURE IF SECURITY AGREEMENT COVERS REAL PROPERTY OR FIXTURES.

(a) [Enforcement: personal and real property.]

If a security agreement covers both personal and real property, a secured party may proceed:

(1) under this part as to the personal property without prejudicing any rights with respect to the real property; or

(2) as to both the personal property and the real property in accordance with the rights with respect to the real property, in which case the other provisions of this part do not apply.

(b) [Enforcement: fixtures.]

Subject to subsection (c), if a security agreement covers goods that are or become fixtures, a secured party may proceed:

(1) under this part; or

(2) in accordance with the rights with respect to real property, in which case the other provisions of this part do not apply.

(c) [Removal of fixtures.]

Subject to the other provisions of this part, if a secured party holding a security interest in fixtures has priority over all owners and encumbrancers of the real property, the secured party, after default, may remove the collateral from the real property.

(d) [Injury caused by removal.]

A secured party that removes collateral shall promptly reimburse any encumbrancer or owner of the real property, other than the debtor, for the cost of repair of any physical injury caused by the removal. The secured party need not reimburse the encumbrancer or owner for any diminution in value of the real property caused by the absence of the goods removed or by any necessity of replacing them. A person entitled to reimbursement may refuse permission to remove until the secured party gives adequate assurance for the performance of the obligation to reimburse.

9-605. UNKNOWN DEBTOR OR SECONDARY OBLIGOR.

A secured party does not owe a duty based on its status as secured party:

(1) to a person that is a debtor or obligor, unless the secured party knows:

(A) that the person is a debtor or obligor;

(B) the identity of the person; and

(C) how to communicate with the person; or

(2) to a secured party or lienholder that has filed a financing statement against a person, unless the secured party knows:

(A) that the person is a debtor; and

(B) the identity of the person.

9-606. TIME OF DEFAULT FOR AGRICULTURAL LIEN.

For purposes of this part, a default occurs in connection with an agricultural lien at the time the secured party becomes entitled to enforce the lien in accordance with the statute under which it was created.

9-607. COLLECTION AND ENFORCEMENT BY SECURED PARTY.

(a) [Collection and enforcement generally.]

If so agreed, and in any event after default, a secured party:

(1) may notify an account debtor or other person obligated on collateral to make payment or otherwise render performance to or for the benefit of the secured party;

(2) may take any proceeds to which the secured party is entitled under Section 9-315;

(3) may enforce the obligations of an account debtor or other person obligated on collateral and exercise the rights of the debtor with respect to the obligation of the account debtor or other person obligated on collateral to make payment or otherwise render performance to the debtor, and with respect to any property that secures the obligations of the account debtor or other person obligated on the collateral;

(4) if it holds a security interest in a deposit account perfected by control under Section 9-104(a)(1), may apply the balance of the deposit account to the obligation secured by the deposit account; and

(5) if it holds a security interest in a deposit account perfected by control under Section 9-104(a)(2) or (3), may instruct the bank to pay the balance of the deposit account to or for the benefit of the secured party.

(b) [Nonjudicial enforcement of mortgage.]

If necessary to enable a secured party to exercise under subsection (a)(3) the right of a debtor to enforce a mortgage nonjudicially, the secured party may record in the office in which a record of the mortgage is recorded:

(1) a copy of the security agreement that creates or provides for a security interest in the obligation secured by the mortgage; and

(2) the secured party's sworn affidavit in recordable form stating that:

(A) a default has occurred; and

(B) the secured party is entitled to enforce the mortgage nonjudicially.

(c) [Commercially reasonable collection and enforcement.]

A secured party shall proceed in a commercially reasonable manner if the secured party:

(1) undertakes to collect from or enforce an obligation of an account debtor or other person obligated on collateral; and

(2) is entitled to charge back uncollected collateral or otherwise to full or limited recourse against the debtor or a secondary obligor.

(d) [Expenses of collection and enforcement.]

A secured party may deduct from the collections made pursuant to subsection (c) reasonable expenses of collection and enforcement, including reasonable attorney's fees and legal expenses incurred by the secured party.

(e) [Duties to secured party not affected.]

This section does not determine whether an account debtor, bank, or other person obligated on collateral owes a duty to a secured party.

9-608. APPLICATION OF PROCEEDS OF COLLECTION OR ENFORCEMENT; LIABILITY FOR DEFICIENCY AND RIGHT TO SURPLUS.

(a) [Application of proceeds, surplus, and deficiency if obligation secured.]

If a security interest or agricultural lien secures payment or performance of an obligation, the following rules apply:

(1) A secured party shall apply or pay over for application the cash proceeds of collection or enforcement under Section 9-607 in the following order to:

(A) the reasonable expenses of collection and enforcement and, to the extent provided for by agreement and not prohibited by law, reasonable attorney's fees and legal expenses incurred by the secured party;

(B) the satisfaction of obligations secured by the security interest or agricultural lien under which the collection or enforcement is made; and

(C) the satisfaction of obligations secured by any subordinate security interest in or other lien on the collateral subject to the security interest or agricultural lien under which the collection or enforcement is made if the secured party receives an authenticated demand for proceeds before distribution of the proceeds is completed.

(2) If requested by a secured party, a holder of a subordinate security interest or other lien shall furnish reasonable proof of the interest or lien within a reasonable time. Unless the holder complies, the secured party need not comply with the holder's demand under paragraph (1)(C).

(3) A secured party need not apply or pay over for application noncash proceeds of collection and enforcement under Section 9-607 unless the failure to do so would be commercially unreasonable. A secured party that applies or pays over for application noncash proceeds shall do so in a commercially reasonable manner.

(4) A secured party shall account to and pay a debtor for any surplus, and the obligor is liable for any deficiency.

(b) [No surplus or deficiency in sales of certain rights to payment.]

If the underlying transaction is a sale of accounts, chattel paper, payment intangibles, or promissory notes, the debtor is not entitled to any surplus, and the obligor is not liable for any deficiency.

9-609. SECURED PARTY'S RIGHT TO TAKE POSSESSION AFTER DEFAULT.

(a) [Possession; rendering equipment unusable; disposition on debtor's premises.]

After default, a secured party:

(1) may take possession of the collateral; and

(2) without removal, may render equipment unusable and dispose of collateral on a debtor's premises under Section 9-610.

(b) [Judicial and nonjudicial process.]

A secured party may proceed under subsection (a):

(1) pursuant to judicial process; or

(2) without judicial process, if it proceeds without breach of the peace.

(c) [Assembly of collateral.]

If so agreed, and in any event after default, a secured party may require the debtor to assemble the collateral and make it available to the secured party at a place to be designated by the secured party which is reasonably convenient to both parties.

9-610. DISPOSITION OF COLLATERAL AFTER DEFAULT.

(a) [Disposition after default.]

After default, a secured party may sell, lease, license, or otherwise dispose of any or all of the collateral in its present condition or following any commercially reasonable preparation or processing.

(b) [Commercially reasonable disposition.]

Every aspect of a disposition of collateral, including the method, manner, time, place, and other terms, must be commercially reasonable. If commercially reasonable, a secured party may dispose of collateral by public or private proceedings, by one or more contracts, as a unit or in parcels, and at any time and place and on any terms.

(c) [Purchase by secured party.]

A secured party may purchase collateral:

(1) at a public disposition; or

(2) at a private disposition only if the collateral is of a kind that is customarily sold on a recognized market or the subject of widely distributed standard price quotations.

(d) [Warranties on disposition.]

A contract for sale, lease, license, or other disposition includes the warranties relating to title, possession, quiet enjoyment, and the like which by operation of law accompany a voluntary disposition of property of the kind subject to the contract.

(e) [Disclaimer of warranties.]

A secured party may disclaim or modify warranties under subsection (d):

(1) in a manner that would be effective to disclaim or modify the warranties in a voluntary disposition of property of the kind subject to the contract of disposition; or

(2) by communicating to the purchaser a record evidencing the contract for disposition and including an express disclaimer or modification of the warranties.

(f) [Record sufficient to disclaim warranties.]

A record is sufficient to disclaim warranties under subsection (e) if it indicates "There is no warranty relating to title, possession, quiet enjoyment, or the like in this disposition" or uses words of similar import.

9-611. NOTIFICATION BEFORE DISPOSITION OF COLLATERAL.

(a) ["Notification date."]

In this section, "notification date" means the earlier of the date on which:

(1) a secured party sends to the debtor and any secondary obligor an authenticated notification of disposition; or

(2) the debtor and any secondary obligor waive the right to notification.

(b) [Notification of disposition required.]

Except as otherwise provided in subsection (d), a secured party that disposes of collateral under Section 9-610 shall send to the persons specified in subsection (c) a reasonable authenticated notification of disposition.

(c) [Persons to be notified.]

To comply with subsection (b), the secured party shall send an authenticated notification of disposition to:

(1) the debtor;

(2) any secondary obligor; and

(3) if the collateral is other than consumer goods:

(A) any other person from which the secured party has received, before the notification date, an authenticated notification of a claim of an interest in the collateral;

(B) any other secured party or lienholder that, 10 days before the notification date, held a security interest in or other lien on the collateral perfected by the filing of a financing statement that:

(i) identified the collateral;

(ii) was indexed under the debtor's name as of that date; and

(iii) was filed in the office in which to file a financing statement against the debtor covering the collateral as of that date; and

(C) any other secured party that, 10 days before the notification date, held a security interest in the collateral perfected by compliance with a statute, regulation, or treaty described in Section 9-311(a).

(d) [Subsection (b) inapplicable: perishable collateral; recognized market.]

Subsection (b) does not apply if the collateral is perishable or threatens to decline speedily in value or is of a type customarily sold on a recognized market.

(e) [Compliance with subsection (c)(3)(B).]

A secured party complies with the requirement for notification prescribed by subsection (c)(3)(B) if:

(1) not later than 20 days or earlier than 30 days before the notification date, the secured party requests, in a commercially reasonable manner, information concerning financing statements indexed under the debtor's name in the office indicated in subsection (c)(3)(B); and

(2) before the notification date, the secured party:

(A) did not receive a response to the request for information; or

(B) received a response to the request for information and sent an authenticated notification of disposition to each secured party or other lienholder named in that response whose financing statement covered the collateral.

9-612. TIMELINESS OF NOTIFICATION BEFORE DISPOSITION OF COLLATERAL.

(a) [Reasonable time is question of fact.]

Except as otherwise provided in subsection (b), whether a notification is sent within a reasonable time is a question of fact.

(b) [10-day period sufficient in non-consumer transaction.]

In a transaction other than a consumer transaction, a notification of disposition sent after default and 10 days or more before the earliest time of disposition set forth in the notification is sent within a reasonable time before the disposition.

9-613. CONTENTS AND FORM OF NOTIFICATION BEFORE DISPOSITION OF COLLATERAL: GENERAL.

Except in a consumer-goods transaction, the following rules apply:

(1) The contents of a notification of disposition are sufficient if the notification:

(A) describes the debtor and the secured party;

(B) describes the collateral that is the subject of the intended disposition;

(C) states the method of intended disposition;

(D) states that the debtor is entitled to an accounting of the unpaid indebtedness and states the charge, if any, for an accounting; and

(E) states the time and place of a public disposition or the time after which any other disposition is to be made.

(2) Whether the contents of a notification that lacks any of the information specified in paragraph (1) are nevertheless sufficient is a question of fact.

(3) The contents of a notification providing substantially the information specified in paragraph (1) are sufficient, even if the notification includes: (A) information not specified by that paragraph; or (B) minor errors that are not seriously misleading.

(4) A particular phrasing of the notification is not required.

(5) The following form of notification and the form appearing in Section 9-614(3), when completed, each provides sufficient information:

NOTIFICATION OF DISPOSITION OF COLLATERAL

To: [Name of debtor, obligor, or other person to which the notification is sent]

From: [Name, address, and telephone number of secured party]

Name of Debtor(s): [Include only if debtor(s) are not an addressee]

[For a public disposition:]

We will sell [or lease or license, as applicable] the [describe collateral] [to the highest qualified bidder] in public as follows:

Day and Date: _____

Time: _____

Place: _____

[For a private disposition:]

We will sell [or lease or license, as applicable] the [describe collateral] privately sometime after [day and date].

You are entitled to an accounting of the unpaid indebtedness secured by the property that we intend to sell [or lease or license, as applicable] [for a charge of $ _____].

You may request an accounting by calling us at [telephone number]

[End of Form]

9-614. CONTENTS AND FORM OF NOTIFICATION BEFORE DISPOSITION OF COLLATERAL: CONSUMER-GOODS TRANSACTION.

In a consumer-goods transaction, the following rules apply:

(1) A notification of disposition must provide the following information:

(A) the information specified in Section 9-613(1);

(B) a description of any liability for a deficiency of the person to which the notification is sent;

(C) a telephone number from which the amount that must be paid to the secured party to redeem the collateral under Section 9-623 is available; and

(D) a telephone number or mailing address from which additional information concerning the disposition and the obligation secured is available.

(2) A particular phrasing of the notification is not required.

(3) The following form of notification, when completed, provides sufficient information:

[Name and address of secured party]

[Date]

NOTICE OF OUR PLAN TO SELL PROPERTY

[Name and address of any obligor who is also a debtor]

Subject: [Identification of Transaction]

We have your [describe collateral], because you broke promises in our agreement.

[For a public disposition:]

We will sell [describe collateral] at public sale. A sale could include a lease or license. The sale will be held as follows:

Date: _____

Time: _____

Place: _____

You may attend the sale and bring bidders if you want.

[For a private disposition:]

We will sell [describe collateral] at private sale sometime after [date]. A sale could include a lease or license.

The money that we get from the sale (after paying our costs) will reduce the amount you owe. If we get less money than you owe, you [will or will not, as applicable]] still owe us the difference. If we get more money than you owe, you will get the extra money, unless we must pay it to someone else.

You can get the property back at any time before we sell it by paying us the full amount you owe (not just the past due payments), including our expenses. To learn the exact amount you must pay, call us at [telephone number]].

If you want us to explain to you in writing how we have figured the amount that you owe us, you may call us at " [telephone number]] [or write us at [secured party's address]] and request a written explanation. [We will charge you $ _____ for the explanation if we sent you another written explanation of the amount you owe us within the last six months.]

If you need more information about the sale call us at [telephone number]] [or write us at [secured party's address]].

We are sending this notice to the following other people who have an interest in [describe collateral] or who owe money under your agreement:

[Names of all other debtors and obligors, if any]

[End of Form]

(4) A notification in the form of paragraph (3) is sufficient, even if additional information appears at the end of the form.

(5) A notification in the form of paragraph (3) is sufficient, even if it includes errors in information not required by paragraph (1), unless the error is misleading with respect to rights arising under this article.

(6) If a notification under this section is not in the form of paragraph (3), law other than this article determines the effect of including information not required by paragraph (1).

9-615. APPLICATION OF PROCEEDS OF DISPOSITION; LIABILITY FOR DEFICIENCY AND RIGHT TO SURPLUS.

(a) [Application of proceeds.]

A secured party shall apply or pay over for application the cash proceeds of disposition under Section 9-610 in the following order to:

(1) the reasonable expenses of retaking, holding, preparing for disposition, processing, and disposing, and, to the extent provided for by agreement and not prohibited by law, reasonable attorney's fees and legal expenses incurred by the secured party;

(2) the satisfaction of obligations secured by the security interest or agricultural lien under which the disposition is made;

(3) the satisfaction of obligations secured by any subordinate security interest in or other subordinate lien on the collateral if:

(A) the secured party receives from the holder of the subordinate security interest or other lien an authenticated demand for proceeds before distribution of the proceeds is completed; and

(B) in a case in which a consignor has an interest in the collateral, the subordinate security interest or other lien is senior to the interest of the consignor; and

(4) a secured party that is a consignor of the collateral if the secured party receives from the consignor an authenticated demand for proceeds before distribution of the proceeds is completed.

(b) [Proof of subordinate interest.]

If requested by a secured party, a holder of a subordinate security interest or other lien shall furnish reasonable proof of the interest or lien within a reasonable time. Unless the holder does so, the secured party need not comply with the holder's demand under subsection (a)(3).

(c) [Application of noncash proceeds.]

A secured party need not apply or pay over for application noncash proceeds of disposition under Section 9-610 unless the failure to do so would be commercially unreasonable. A secured party that applies or pays over for application noncash proceeds shall do so in a commercially reasonable manner.

(d) [Surplus or deficiency if obligation secured.]

If the security interest under which a disposition is made secures payment or performance of an obligation, after making the payments and applications required by subsection (a) and permitted by subsection (c):

(1) unless subsection (a)(4) requires the secured party to apply or pay over cash proceeds to a consignor, the secured party shall account to and pay a debtor for any surplus; and

(2) the obligor is liable for any deficiency.

(e) [No surplus or deficiency in sales of certain rights to payment.]

If the underlying transaction is a sale of accounts, chattel paper, payment intangibles, or promissory notes:

(1) the debtor is not entitled to any surplus; and

(2) the obligor is not liable for any deficiency.

(f) [Calculation of surplus or deficiency in disposition to person related to secured party.]

The surplus or deficiency following a disposition is calculated based on the amount of proceeds that would have been realized in a disposition complying with this part to a transferee other than the secured party, a person related to the secured party, or a secondary obligor if:

(1) the transferee in the disposition is the secured party, a person related to the secured party, or a secondary obligor; and

(2) the amount of proceeds of the disposition is significantly below the range of proceeds that a complying disposition to a person other than the secured party, a person related to the secured party, or a secondary obligor would have brought.

(g) [Cash proceeds received by junior secured party.]

A secured party that receives cash proceeds of a disposition in good faith and without knowledge that the receipt violates the rights of the holder of a security interest or other lien that is not subordinate to the security interest or agricultural lien under which the disposition is made:

(1) takes the cash proceeds free of the security interest or other lien;

(2) is not obligated to apply the proceeds of the disposition to the satisfaction of obligations secured by the security interest or other lien; and

(3) is not obligated to account to or pay the holder of the security interest or other lien for any surplus.

9-616. EXPLANATION OF CALCULATION OF SURPLUS OR DEFICIENCY.

(a) [Definitions.]

In this section:

(1) "Explanation" means a writing that:

(A) states the amount of the surplus or deficiency;

(B) provides an explanation in accordance with subsection (c) of how the secured party calculated the surplus or deficiency;

(C) states, if applicable, that future debits, credits, charges, including additional credit service charges or interest, rebates, and expenses may affect the amount of the surplus or deficiency; and

(D) provides a telephone number or mailing address from which additional information concerning the transaction is available.

(2) "Request" means a record:

(A) authenticated by a debtor or consumer obligor;

(B) requesting that the recipient provide an explanation; and

(C) sent after disposition of the collateral under Section 9-610.

(b) [Explanation of calculation.]

In a consumer-goods transaction in which the debtor is entitled to a surplus or a consumer obligor is liable for a deficiency under Section 9-615, the secured party shall:

(1) send an explanation to the debtor or consumer obligor, as applicable, after the disposition and:

(A) before or when the secured party accounts to the debtor and pays any surplus or first makes written demand on the consumer obligor after the disposition for payment of the deficiency; and

(B) within 14 days after receipt of a request; or

(2) in the case of a consumer obligor who is liable for a deficiency, within 14 days after receipt of a request, send to the consumer obligor a record waiving the secured party's right to a deficiency.

(c) [Required information.]

To comply with subsection (a)(1)(B), a writing must provide the following information in the following order:

(1) the aggregate amount of obligations secured by the security interest under which the disposition was made, and, if the amount reflects a rebate of unearned interest or credit service charge, an indication of that fact, calculated as of a specified date:

(A) if the secured party takes or receives possession of the collateral after default, not more than 35 days before the secured party takes or receives possession; or

(B) if the secured party takes or receives possession of the collateral before default or does not take possession of the collateral, not more than 35 days before the disposition;

(2) the amount of proceeds of the disposition;

(3) the aggregate amount of the obligations after deducting the amount of proceeds;

(4) the amount, in the aggregate or by type, and types of expenses, including expenses of retaking, holding, preparing for disposition, processing, and disposing of the collateral, and attorney's fees secured by the collateral which are known to the secured party and relate to the current disposition;

(5) the amount, in the aggregate or by type, and types of credits, including rebates of interest or credit service charges, to which the obligor is known to be entitled and which are not reflected in the amount in paragraph (1); and

(6) the amount of the surplus or deficiency.

(d) [Substantial compliance.]

A particular phrasing of the explanation is not required. An explanation complying substantially with the requirements of subsection (a) is sufficient, even if it includes minor errors that are not seriously misleading.

(e) [Charges for responses.]

A debtor or consumer obligor is entitled without charge to one response to a request under this section during any six-month period in which the secured party did not send to the debtor or consumer obligor an explanation pursuant to subsection (b)(1). The secured party may require payment of a charge not exceeding $25 for each additional response.

9-617. RIGHTS OF TRANSFEREE OF COLLATERAL.

(a) [Effects of disposition.]

A secured party's disposition of collateral after default:

(1) transfers to a transferee for value all of the debtor's rights in the collateral;

(2) discharges the security interest under which the disposition is made; and

(3) discharges any subordinate security interest or other subordinate lien [other than liens created under [cite acts or statutes providing for liens, if any, that are not to be discharged]].

(b) [Rights of good-faith transferee.]

A transferee that acts in good faith takes free of the rights and interests described in subsection (a), even if the secured party fails to comply with this article or the requirements of any judicial proceeding.

(c) [Rights of other transferee.]

If a transferee does not take free of the rights and interests described in subsection (a), the transferee takes the collateral subject to:

(1) the debtor's rights in the collateral;

(2) the security interest or agricultural lien under which the disposition is made; and

(3) any other security interest or other lien.

9-618. RIGHTS AND DUTIES OF CERTAIN SECONDARY OBLIGORS.

(a) [Rights and duties of secondary obligor.]

A secondary obligor acquires the rights and becomes obligated to perform the duties of the secured party after the secondary obligor:

(1) receives an assignment of a secured obligation from the secured party;

(2) receives a transfer of collateral from the secured party and agrees to accept the rights and assume the duties of the secured party; or

(3) is subrogated to the rights of a secured party with respect to collateral.

(b) [Effect of assignment, transfer, or subrogation.]

An assignment, transfer, or subrogation described in subsection (a):

(1) is not a disposition of collateral under Section 9-610; and

(2) relieves the secured party of further duties under this article.

9-619. TRANSFER OF RECORD OR LEGAL TITLE.

(a) ["Transfer statement."]

In this section, "transfer statement" means a record authenticated by a secured party stating:

(1) that the debtor has defaulted in connection with an obligation secured by specified collateral;

(2) that the secured party has exercised its post-default remedies with respect to the collateral;

(3) that, by reason of the exercise, a transferee has acquired the rights of the debtor in the collateral; and

(4) the name and mailing address of the secured party, debtor, and transferee.

(b) [Effect of transfer statement.]

A transfer statement entitles the transferee to the transfer of record of all rights of the debtor in the collateral specified in the statement in any official filing, recording, registration, or certificate-of-title system covering the collateral. If a transfer statement is presented with the applicable fee and request form to the official or office responsible for maintaining the system, the official or office shall:

(1) accept the transfer statement;

(2) promptly amend its records to reflect the transfer; and

(3) if applicable, issue a new appropriate certificate of title in the name of the transferee.

(c) [Transfer not a disposition; no relief of secured party's duties.]

A transfer of the record or legal title to collateral to a secured party under subsection (b) or otherwise is not of itself a disposition of collateral under this article and does not of itself relieve the secured party of its duties under this article.

9-620. ACCEPTANCE OF COLLATERAL IN FULL OR PARTIAL SATISFACTION OF OBLIGATION; COMPULSORY DISPOSITION OF COLLATERAL.

(a) [Conditions to acceptance in satisfaction.]

Except as otherwise provided in subsection (g), a secured party may accept collateral in full or partial satisfaction of the obligation it secures only if:

(1) the debtor consents to the acceptance under subsection (c);

(2) the secured party does not receive, within the time set forth in subsection (d), a notification of objection to the proposal authenticated by:

(A) a person to which the secured party was required to send a proposal under Section 9-621; or

(B) any other person, other than the debtor, holding an interest in the collateral subordinate to the security interest that is the subject of the proposal;

(3) if the collateral is consumer goods, the collateral is not in the possession of the debtor when the debtor consents to the acceptance; and

(4) subsection (e) does not require the secured party to dispose of the collateral or the debtor waives the requirement pursuant to Section 9-624.

(b) [Purported acceptance ineffective.]

A purported or apparent acceptance of collateral under this section is ineffective unless:

(1) the secured party consents to the acceptance in an authenticated record or sends a proposal to the debtor; and

(2) the conditions of subsection (a) are met.

(c) [Debtor's consent.]

For purposes of this section:

(1) a debtor consents to an acceptance of collateral in partial satisfaction of the obligation it secures only if the debtor agrees to the terms of the acceptance in a record authenticated after default; and

(2) a debtor consents to an acceptance of collateral in full satisfaction of the obligation it secures only if the debtor agrees to the terms of the acceptance in a record authenticated after default or the secured party:

(A) sends to the debtor after default a proposal that is unconditional or subject only to a condition that collateral not in the possession of the secured party be preserved or maintained;

(B) in the proposal, proposes to accept collateral in full satisfaction of the obligation it secures; and

(C) does not receive a notification of objection authenticated by the debtor within 20 days after the proposal is sent.

(d) [Effectiveness of notification.]

To be effective under subsection (a)(2), a notification of objection must be received by the secured party:

(1) in the case of a person to which the proposal was sent pursuant to Section 9-621, within 20 days after notification was sent to that person; and

(2) in other cases:

(A) within 20 days after the last notification was sent pursuant to Section 9-621; or

(B) if a notification was not sent, before the debtor consents to the acceptance under subsection (c).

(e) [Mandatory disposition of consumer goods.]

A secured party that has taken possession of collateral shall dispose of the collateral pursuant to Section 9-610 within the time specified in subsection (f) if:

(1) 60 percent of the cash price has been paid in the case of a purchase-money security interest in consumer goods; or

(2) 60 percent of the principal amount of the obligation secured has been paid in the case of a non-purchase-money security interest in consumer goods.

(f) [Compliance with mandatory disposition requirement.]

To comply with subsection (e), the secured party shall dispose of the collateral:

(1) within 90 days after taking possession; or

(2) within any longer period to which the debtor and all secondary obligors have agreed in an agreement to that effect entered into and authenticated after default.

(g) [No partial satisfaction in consumer transaction.]

In a consumer transaction, a secured party may not accept collateral in partial satisfaction of the obligation it secures.

9-621. NOTIFICATION OF PROPOSAL TO ACCEPT COLLATERAL.

(a) [Persons to which proposal to be sent.]

A secured party that desires to accept collateral in full or partial satisfaction of the obligation it secures shall send its proposal to:

(1) any person from which the secured party has received, before the debtor consented to the acceptance, an authenticated notification of a claim of an interest in the collateral;

(2) any other secured party or lienholder that, 10 days before the debtor consented to the acceptance, held a security interest in or other lien on the collateral perfected by the filing of a financing statement that:

(A) identified the collateral;

(B) was indexed under the debtor's name as of that date; and

(C) was filed in the office or offices in which to file a financing statement against the debtor covering the collateral as of that date; and

(3) any other secured party that, 10 days before the debtor consented to the acceptance, held a security interest in the collateral perfected by compliance with a statute, regulation, or treaty described in Section 9-311(a).

(b) [Proposal to be sent to secondary obligor in partial satisfaction.]

A secured party that desires to accept collateral in partial satisfaction of the obligation it secures shall send its proposal to any secondary obligor in addition to the persons described in subsection (a).

9-622. EFFECT OF ACCEPTANCE OF COLLATERAL.

(a) [Effect of acceptance.]

A secured party's acceptance of collateral in full or partial satisfaction of the obligation it secures:

(1) discharges the obligation to the extent consented to by the debtor;

(2) transfers to the secured party all of a debtor's rights in the collateral;

(3) discharges the security interest or agricultural lien that is the subject of the debtor's consent and any subordinate security interest or other subordinate lien; and

(4) terminates any other subordinate interest.

(b) [Discharge of subordinate interest notwithstanding noncompliance.]

A subordinate interest is discharged or terminated under subsection (a), even if the secured party fails to comply with this article.

9-623. RIGHT TO REDEEM COLLATERAL.

(a) [Persons that may redeem.]

A debtor, any secondary obligor, or any other secured party or lienholder may redeem collateral.

(b) [Requirements for redemption.]

To redeem collateral, a person shall tender:

(1) fulfillment of all obligations secured by the collateral; and

(2) the reasonable expenses and attorney's fees described in Section 9-615(a)(1).

(c) [When redemption may occur.]

A redemption may occur at any time before a secured party:

(1) has collected collateral under Section 9-607;

(2) has disposed of collateral or entered into a contract for its disposition under Section 9-610; or

(3) has accepted collateral in full or partial satisfaction of the obligation it secures under Section 9-622.

9-624. WAIVER.

(a) [Waiver of disposition notification.]

A debtor or secondary obligor may waive the right to notification of disposition of collateral under Section 9-611 only by an agreement to that effect entered into and authenticated after default.

(b) [Waiver of mandatory disposition.]

A debtor may waive the right to require disposition of collateral under Section 9-620(e) only by an agreement to that effect entered into and authenticated after default.

(c) [Waiver of redemption right.]

Except in a consumer-goods transaction, a debtor or secondary obligor may waive the right to redeem collateral under Section 9-623 only by an agreement to that effect entered into and authenticated after default.

[Subpart 2. Noncompliance with Article] [Table of Contents]

9-625. REMEDIES FOR SECURED PARTY'S FAILURE TO COMPLY WITH ARTICLE.

(a) [Judicial orders concerning noncompliance.]

If it is established that a secured party is not proceeding in accordance with this article, a court may order or restrain collection, enforcement, or disposition of collateral on appropriate terms and conditions.

(b) [Damages for noncompliance.]

Subject to subsections (c), (d), and (f), a person is liable for damages in the amount of any loss caused by a failure to comply with this article. Loss caused by a failure to comply may include loss resulting from the debtor's inability to obtain, or increased costs of, alternative financing.

(c) [Persons entitled to recover damages; statutory damages in consumer-goods transaction.]

Except as otherwise provided in Section 9-628:

(1) a person that, at the time of the failure, was a debtor, was an obligor, or held a security interest in or other lien on the collateral may recover damages under subsection (b) for its loss; and

(2) if the collateral is consumer goods, a person that was a debtor or a secondary obligor at the time a secured party failed to comply with this part may recover for that failure in any event an amount not less than the credit service charge plus 10 percent of the principal amount of the obligation or the time-price differential plus 10 percent of the cash price.

(d) [Recovery when deficiency eliminated or reduced.]

A debtor whose deficiency is eliminated under Section 9-626 may recover damages for the loss of any surplus. However, a debtor or secondary obligor whose deficiency is eliminated or reduced under Section 9-626 may not otherwise recover under subsection (b) for noncompliance with the provisions of this part relating to collection, enforcement, disposition, or acceptance.

(e) [Statutory damages: noncompliance with specified provisions.]

In addition to any damages recoverable under subsection (b), the debtor, consumer obligor, or person named as a debtor in a filed record, as applicable, may recover $500 in each case from a person that:

(1) fails to comply with Section 9-208;

(2) fails to comply with Section 9-209;

(3) files a record that the person is not entitled to file under Section 9-509(a);

(4) fails to cause the secured party of record to file or send a termination statement as required by Section 9-513(a) or (c);

(5) fails to comply with Section 9-616(b)(1) and whose failure is part of a pattern, or consistent with a practice, of noncompliance; or

(6) fails to comply with Section 9-616(b)(2).

(f) [Statutory damages: noncompliance with Section 9-210.]

A debtor or consumer obligor may recover damages under subsection (b) and, in addition, $500 in each case from a person that, without reasonable cause, fails to comply with a request under Section 9-210. A recipient of a request under Section 9-210 which never claimed an interest in the collateral or obligations that are the subject of a request under that section has a reasonable excuse for failure to comply with the request within the meaning of this subsection.

(g) [Limitation of security interest: noncompliance with Section 9-210.]

If a secured party fails to comply with a request regarding a list of collateral or a statement of account under Section 9-210, the secured party may claim a security interest only as shown in the list or statement included in the request as against a person that is reasonably misled by the failure.

9-626. ACTION IN WHICH DEFICIENCY OR SURPLUS IS IN ISSUE.

(a) [Applicable rules if amount of deficiency or surplus in issue.]

In an action arising from a transaction, other than a consumer transaction, in which the amount of a deficiency or surplus is in issue, the following rules apply:

(1) A secured party need not prove compliance with the provisions of this part relating to collection, enforcement, disposition, or acceptance unless the debtor or a secondary obligor places the secured party's compliance in issue.

(2) If the secured party's compliance is placed in issue, the secured party has the burden of establishing that the collection, enforcement, disposition, or acceptance was conducted in accordance with this part.

(3) Except as otherwise provided in Section 9-628, if a secured party fails to prove that the collection, enforcement, disposition, or acceptance was conducted in accordance with the provisions of this part relating to collection, enforcement, disposition, or acceptance, the liability of a debtor or a secondary obligor for a deficiency is limited to an amount by which the sum of the secured obligation, expenses, and attorney's fees exceeds the greater of:

(A) the proceeds of the collection, enforcement, disposition, or acceptance; or

(B) the amount of proceeds that would have been realized had the noncomplying secured party proceeded in accordance with the provisions of this part relating to collection, enforcement, disposition, or acceptance.

(4) For purposes of paragraph (3)(B), the amount of proceeds that would have been realized is equal to the sum of the secured obligation, expenses, and attorney's fees unless the secured party proves that the amount is less than that sum.

(5) If a deficiency or surplus is calculated under Section 9-615(f), the debtor or obligor has the burden of establishing that the amount of proceeds of the disposition is significantly below the range of prices that a complying disposition to a person other than the secured party, a person related to the secured party, or a secondary obligor would have brought.

(b) [Non-consumer transactions; no inference.]

The limitation of the rules in subsection (a) to transactions other than consumer transactions is intended to leave to the court the determination of the proper rules in consumer transactions. The court may not infer from that limitation the nature of the proper rule in consumer transactions and may continue to apply established approaches.

9-627. DETERMINATION OF WHETHER CONDUCT WAS COMMERCIALLY REASONABLE.

(a) [Greater amount obtainable under other circumstances; no preclusion of commercial reasonableness.]

The fact that a greater amount could have been obtained by a collection, enforcement, disposition, or acceptance at a different time or in a different method from that selected by the secured party is not of itself sufficient to preclude the secured party from establishing that the collection, enforcement, disposition, or acceptance was made in a commercially reasonable manner.

(b) [Dispositions that are commercially reasonable.]

A disposition of collateral is made in a commercially reasonable manner if the disposition is made:

(1) in the usual manner on any recognized market;

(2) at the price current in any recognized market at the time of the disposition; or

(3) otherwise in conformity with reasonable commercial practices among dealers in the type of property that was the subject of the disposition.

(c) [Approval by court or on behalf of creditors.]

A collection, enforcement, disposition, or acceptance is commercially reasonable if it has been approved:

(1) in a judicial proceeding;

(2) by a bona fide creditors' committee;

(3) by a representative of creditors; or

(4) by an assignee for the benefit of creditors.

(d) [Approval under subsection (c) not necessary; absence of approval has no effect.]

Approval under subsection (c) need not be obtained, and lack of approval does not mean that the collection, enforcement, disposition, or acceptance is not commercially reasonable.

9-628. NONLIABILITY AND LIMITATION ON LIABILITY OF SECURED PARTY; LIABILITY OF SECONDARY OBLIGOR.

(a) [Limitation of liability of secured party for noncompliance with article.]

Unless a secured party knows that a person is a debtor or obligor, knows the identity of the person, and knows how to communicate with the person:

(1) the secured party is not liable to the person, or to a secured party or lienholder that has filed a financing statement against the person, for failure to comply with this article; and

(2) the secured party's failure to comply with this article does not affect the liability of the person for a deficiency.

(b) [Limitation of liability based on status as secured party.]

A secured party is not liable because of its status as secured party:

(1) to a person that is a debtor or obligor, unless the secured party knows:

(A) that the person is a debtor or obligor;

(B) the identity of the person; and

(C) how to communicate with the person; or

(2) to a secured party or lienholder that has filed a financing statement against a person, unless the secured party knows:

(A) that the person is a debtor; and

(B) the identity of the person.

(c) [Limitation of liability if reasonable belief that transaction not a consumer-goods transaction or consumer transaction.]

A secured party is not liable to any person, and a person's liability for a deficiency is not affected, because of any act or omission arising out of the secured party's reasonable belief that a transaction is not a consumer-goods transaction or a consumer transaction or that goods are not consumer goods, if the secured party's belief is based on its reasonable reliance on:

(1) a debtor's representation concerning the purpose for which collateral was to be used, acquired, or held; or

(2) an obligor's representation concerning the purpose for which a secured obligation was incurred.

(d) [Limitation of liability for statutory damages.]

A secured party is not liable to any person under Section 9-625(c)(2) for its failure to comply with Section 9-616.

(e) [Limitation of multiple liability for statutory damages.]

A secured party is not liable under Section 9-625(c)(2) more than once with respect to any one secured obligation.

Part 7. Transition [Table of Contents]

9-701. EFFECTIVE DATE.

This [Act] takes effect on July 1, 2001.

9-702. SAVINGS CLAUSE.

(a) [Pre-effective-date transactions or liens.]

Except as otherwise provided in this part, this [Act] applies to a transaction or lien within its scope, even if the transaction or lien was entered into or created before this [Act] takes effect..

(b) [Continuing validity.]

Except as otherwise provided in subsection (c) and Sections 9-703 through 9-709:

(1) transactions and liens that were not governed by [former Article 9], were validly entered into or created before this [Act] takes effect, and would be subject to this [Act] if they had been entered into or created after this [Act] takes effect, and the rights, duties, and interests flowing from those transactions and liens remain valid after this [Act] takes effect; and

(2) the transactions and liens may be terminated, completed, consummated, and enforced as required or permitted by this [Act] or by the law that otherwise would apply if this [Act] had not taken effect.

(c) [Pre-effective-date proceedings.]

This [Act] does not affect an action, case, or proceeding commenced before this [Act] takes effect.

9-703. SECURITY INTEREST PERFECTED BEFORE EFFECTIVE DATE.

(a) [Continuing priority over lien creditor: perfection requirements satisfied.]

A security interest that is enforceable immediately before this [Act] takes effect and would have priority over the rights of a person that becomes a lien creditor at that time is a perfected security interest under this [Act] if, when this [Act] takes effect, the applicable requirements for enforceability and perfection under this [Act] are satisfied without further action.

(b) [Continuing priority over lien creditor: perfection requirements not satisfied.]

Except as otherwise provided in Section 9-705, if, immediately before this [Act] takes effect, a security interest is enforceable and would have priority over the rights of a person that becomes a lien creditor at that time, but the applicable requirements for enforceability or perfection under this [Act] are not satisfied when this [Act] takes effect, the security interest:

(1) is a perfected security interest for one year after this [Act] takes effect;

(2) remains enforceable thereafter only if the security interest becomes enforceable under Section 9-203 before the year expires; and

(3) remains perfected thereafter only if the applicable requirements for perfection under this [Act] are satisfied before the year expires.

9-704. SECURITY INTEREST UNPERFECTED BEFORE EFFECTIVE DATE.

A security interest that is enforceable immediately before this [Act] takes effect but which would be subordinate to the rights of a person that becomes a lien creditor at that time:

(1) remains an enforceable security interest for one year after this [Act] takes effect;

(2) remains enforceable thereafter if the security interest becomes enforceable under Section 9-203 when this [Act] takes effect or within one year thereafter; and

(3) becomes perfected:

(A) without further action, when this [Act] takes effect if the applicable requirements for perfection under this [Act] are satisfied before or at that time; or

(B) when the applicable requirements for perfection are satisfied if the requirements are satisfied after that time.

9-705. EFFECTIVENESS OF ACTION TAKEN BEFORE EFFECTIVE DATE.

(a) [Pre-effective-date action; one-year perfection period unless reperfected.]

If action, other than the filing of a financing statement, is taken before this [Act] takes effect and the action would have resulted in priority of a security interest over the rights of a person that becomes a lien creditor had the security interest become enforceable before this [Act] takes effect, the action is effective to perfect a security interest that attaches under this [Act] within one year after this [Act] takes effect. An attached security interest becomes unperfected one year after this [Act] takes effect unless the security interest becomes a perfected security interest under this [Act] before the expiration of that period.

(b) [Pre-effective-date filing.]

The filing of a financing statement before this [Act] takes effect is effective to perfect a security interest to the extent the filing would satisfy the applicable requirements for perfection under this [Act].

(c) [Pre-effective-date filing in jurisdiction formerly governing perfection.]

This [Act] does not render ineffective an effective financing statement that, before this [Act] takes effect, is filed and satisfies the applicable requirements for perfection under the law of the jurisdiction governing perfection as provided in [former Section 9-103]. However, except as otherwise provided in subsections (d) and (e) and Section 9-706, the financing statement ceases to be effective at the earlier of:

(1) the time the financing statement would have ceased to be effective under the law of the jurisdiction in which it is filed; or

(2) June 30, 2006.

(d) [Continuation statement.]

The filing of a continuation statement after this [Act] takes effect does not continue the effectiveness of the financing statement filed before this [Act] takes effect. However, upon the timely filing of a continuation statement after this [Act] takes effect and in accordance with the law of the jurisdiction governing perfection as provided in Part 3, the effectiveness of a financing statement filed in the same office in that jurisdiction before this [Act] takes effect continues for the period provided by the law of that jurisdiction.

(e) [Application of subsection (c)(2) to transmitting utility financing statement.]

Subsection (c)(2) applies to a financing statement that, before this [Act] takes effect, is filed against a transmitting utility and satisfies the applicable requirements for perfection under the law of the jurisdiction governing perfection as provided in [former Section 9-103] only to the extent that Part 3 provides that the law of a jurisdiction other than the jurisdiction in which the financing statement is filed governs perfection of a security interest in collateral covered by the financing statement.

(f) [Application of Part 5.]

A financing statement that includes a financing statement filed before this [Act] takes effect and a continuation statement filed after this [Act] takes effect is effective only to the extent that it satisfies the requirements of Part 5 for an initial financing statement.

9-706. WHEN INITIAL FINANCING STATEMENT SUFFICES TO CONTINUE EFFECTIVENESS OF FINANCING STATEMENT.

(a) [Initial financing statement in lieu of continuation statement.]

The filing of an initial financing statement in the office specified in Section 9-501 continues the effectiveness of a financing statement filed before this [Act] takes effect if:

(1) the filing of an initial financing statement in that office would be effective to perfect a security interest under this [Act];

(2) the pre-effective-date financing statement was filed in an office in another State or another office in this State; and

(3) the initial financing statement satisfies subsection (c).

(b) [Period of continued effectiveness.]

The filing of an initial financing statement under subsection (a) continues the effectiveness of the pre-effective-date financing statement:

(1) if the initial financing statement is filed before this [Act] takes effect, for the period provided in [former Section 9-403] with respect to a financing statement; and

(2) if the initial financing statement is filed after this [Act] takes effect, for the period provided in Section 9-515 with respect to an initial financing statement.

(c) [Requirements for initial financing statement under subsection (a).]

To be effective for purposes of subsection (a), an initial financing statement must:

(1) satisfy the requirements of Part 5 for an initial financing statement;

(2) identify the pre-effective-date financing statement by indicating the office in which the financing statement was filed and providing the dates of filing and file numbers, if any, of the financing statement and of the most recent continuation statement filed with respect to the financing statement; and

(3) indicate that the pre-effective-date financing statement remains effective.

9-707. AMENDMENT OF PRE-EFFECTIVE-DATE FINANCING STATEMENT.

(a) ["Pre-effective-date financing statement".]

In this section, "pre- effective-date financing statement" means a financing statement filed before this [Act] takes effect.

(b) [Applicable law.]

After this [Act] takes effect, a person may add or delete collateral covered by, continue or terminate the effectiveness of, or otherwise amend the information provided in, a pre-effective-date financing statement only in accordance with the law of the jurisdiction governing perfection as provided in Part 3. However, the effectiveness of a pre- effective-date financing statement also may be terminated in accordance with the law of the jurisdiction in which the financing statement is filed.

(c) [Method of amending: general rule.]

Except as otherwise provided in subsection (d), if the law of this State governs perfection of a security interest, the information in a pre-effective-date financing statement may be amended after this [Act] takes effect only if:

(1) the pre-effective-date financing statement and an amendment are filed in the office specified in Section 9-501;

(2) an amendment is filed in the office specified in Section 9-501 concurrently with, or after the filing in that office of, an initial financing statement that satisfies Section 9-706(c); or

(3) an initial financing statement that provides the information as amended and satisfies Section 9-706(c) is filed in the office specified in Section 9-501.

(d) [Method of amending: continuation.]

If the law of this State governs perfection of a security interest, the effectiveness of a pre-effective-date financing statement may be continued only under Section 9-705(d) and (f) or 9-706.

(e) [Method of amending: additional termination rule.]

Whether or not the law of this State governs perfection of a security interest, the effectiveness of a pre-effective-date financing statement filed in this State may be terminated after this [Act] takes effect by filing a termination statement in the office in which the pre-effective-date financing statement is filed, unless an initial financing statement that satisfies Section 9-706(c) has been filed in the office specified by the law of the jurisdiction governing perfection as provided in Part 3 as the office in which to file a financing statement.

9-708. PERSONS ENTITLED TO FILE INITIAL FINANCING STATEMENT OR CONTINUATION STATEMENT.

A person may file an initial financing statement or a continuation statement under this part if:

(1) the secured party of record authorizes the filing; and

(2) the filing is necessary under this part:

(A) to continue the effectiveness of a financing statement filed before this [Act] takes effect; or

(B) to perfect or continue the perfection of a security interest.

9-709. PRIORITY.

(a) [Law governing priority.]

This [Act] determines the priority of conflicting claims to collateral. However, if the relative priorities of the claims were established before this [Act] takes effect, [former Article 9] determines priority.

(b) [Priority if security interest becomes enforceable under Section 9-203.]

For purposes of Section 9-322(a), the priority of a security interest that becomes enforceable under Section 9-203 of this [Act] dates from the time this [Act] takes effect if the security interest is perfected under this [Act] by the filing of a financing statement before this [Act] takes effect which would not have been effective to perfect the security interest under [former Article 9]. This subsection does not apply to conflicting security interests each of which is perfected by the filing of such a financing statement.